Standing Committee
for Economic and Commercial Cooperation
of the Organization of Islamic Cooperation (COMCEC)

Developing Islamic Finance Strategies In the OIC Member Countries

COMCEC Coordination Office
March 2016

Standing Committee
for Economic and Commercial Cooperation
of the Organization of Islamic Cooperation (COMCEC)

Developing Islamic Finance Strategies In the OIC Member Countries

COMCEC Coordination Office
March 2016

For further information please contact:
The COMCEC Coordination Office
Necatibey Caddesi No:110/A
06100 Yücetepe
Ankara/TURKEY
Phone : 90 312 294 57 10
Fax : 90 312 294 57 77
Web: www.comcec.org

Table of Contents

List of Tables

List of Figures

List of Box

List of Abbreviations

AAOIFI: Accounting and Auditing Organisation for Islamic Financial Institutions

ASEAN: Association of Southeast Asian Nations

AUM: Assets Under Management

CAGR: Compound Annual Growth Rate

CAR: Capital Adequacy ratio

COMCEC: The Standing Committee for Economic and Commercial Cooperation of the Organization of the Islamic Cooperation

GFC: Global Financial Crisis

GIFR: Global Islamic Finance Report

ICM: Islamic Capital Market

IFRS: International Financial Reporting Standards

IFS: Islamic Finance Strategy

IFSB: Islamic Financial Services Board

IIFM: International Islamic Financial Market (

IIFS: Institutions Offering Islamic Financial Services

ISDA: International Swaps and Derivatives Association

MENA: Middle East and Nort Africa

OIC: Organization of Islamic Cooperation

ROAE: Returns On Avg Equity

RoW: Rest of the World

SME: Small and Medium Enterprises

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.

Islamic finance focuses on adhering to Shariah standards and providing financial services and products to Muslim investors that are looking to invest in only Shariah compliant assets and secular[1] investors that are looking to invest in ethically-based assets. 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, and 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.

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.

Since 2007, there have been substantial shifts in the global financial services industry. There has been an increase in both the level and pace of change, and changes in the fundamental basis of finance in a short period of time. This has created both opportunities and challenges for the Islamic Finance industry.

Developing and implementing a National Islamic Finance Strategy is vital for growing the Islamic Finance industry in a given country. There are several components that go into a National Islamic Finance strategy. This report provides a framework of what components are needed in order to develop an effective National Islamic Finance Strategy that will provide the needed infrastructure to grow the Islamic Finance industry and contribute to national economic growth. Recommendations are also provided in which national Islamic finance industry stakeholders may reference in order to develop the needed infrastructure for Islamic finance industry development in a given OIC member country.

Highlights from the Report

1. 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 in Chapter 1 and the OIC Report Survey in Chapter 2.

2. The SWOT analysis included in this report goes through the strengths, weaknesses, opportunities, and threats that the Islamic finance industry is facing.

[1] Secular countries are countries that are not subject or bound to religious rule.

3. The OIC Report Survey looks at what can be improved from the perspectives of Islamic Finance industry members and researchers.
4. A roadmap to developing an Islamic Finance Strategy (IFS) is presented, which provides a reference for a developing a National Islamic Finance Strategy and emphasizes the major components needed in order for the strategy to be effective. The Legal and Conceptual Framework for IFS, Time Scope for IFS, Main Challenges and Obstacles in initial steps and implementation of IFS, Main Components of IFS, Measurement and Evaluation of IFS are included in detail to cover all of the steps needed in order to develop, implement, and monitor progress of a National Islamic Finance Strategy.

5. Data from industry and economic reports, research publications, macroeconomic data, and the OIC Survey were analyzed in order to derive the set of 6 recommendations listed in Table 1.0 and described in detail in Chapter 4. These recommendations go through the ways that the Islamic Finance industry can be further improved, the means of assessing progress on these suggested improvements, and the objectives for Islamic finance industry stakeholders to focus on in order to accomplish these recommendations in Chapter 4.

Background and Methodology

Multiple countries have developed Islamic Finance Strategies, but there are still several countries that have not made Islamic Finance a priority and thus have not developed an Islamic Finance Strategy. The main objectives included in the Islamic Finance strategies from these countries are increasing awareness of Islamic Finance, building a better infrastructure for Islamic finance, continuing to promote innovation in Islamic Finance, and cultivating human capital. These objectives coincide with the recommendations in this report in several ways.

Examples of countries that are leading this effort of developing National Islamic Finance Strategies for the expansion of Islamic finance are Pakistan, Turkey, Qatar, and Indonesia. Turkey is creating a legislation committee to ensure that all institutions will be subject to the same regulations. The Turkish legislation committee is also developing certifications in interest-free finance. A public campaign to promote the image of Islamic finance is being launched by the Turkish government and projects that are developed by the Undersecretariat of Treasury will be funded by participation banks using Mudarabah. Pakistan has developed a new alternative dispute resolution mechanism to better resolve disputes between Islamic financial parties and has also creating a comprehensive Shariah governance framework. In Indonesia, Bank Indonesia has developed a Grand Strategy of Islamic Banking Market Development, which includes a new mapping of Islamic banking market segmentation, Product Development Program, Service Improvement Program, New Image Program, and Public Education and Industrial Communication Program.

These countries have effective components of a National Islamic Strategic plan. The main components needed for a complete Islamic Finance Strategy are shown in Chapter 2, along with the time scope, measurement and evaluation, and suggested types of stakeholders in Chapter 4. This provides guidance of which type of stakeholder should be responsible for each particular segment of the Islamic Finance Strategy as well as a timeframe in which to develop and implement each component of the IFS.

The survey collects responses from a sample of over 150 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. The status of Islamic Finance in OIC Countries is also examined at the macroeconomic level in Chapter 3.

The objectives of this report are to:

- Determine the current status of Islamic Finance industry segments, infrastructure, and national Islamic Finance Strategies.
- Create a SWOT analysis for Islamic finance industry segments to provide further insight onto what is needed for the strategic plan by analyzing the current Islamic finance environment.
- Perform a macroeconomic analysis of OIC member countries.
- Develop a set of recommendations that can be utilized by Islamic finance industry stakeholders to further grow the Islamic finance industry.
- Create a Roadmap and Time Scope for developing and implementing a National Islamic Finance Strategy.
- Determine and state the main challenges and obstacles in the initial steps and implementation of IFS as to take this into consideration when developing a National Islamic Finance Strategy.
- Provide a means of measuring and evaluation the effectiveness of the National Islamic Finance Strategy.

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

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

The Six Recommendations determined from the findings of this report are shown in Table 1. 0 on the following page. These can be used by Islamic Finance industry stakeholders as a means to reference what is needed in order to further the Islamic finance industry in their home country. There is a framework for the implementation of the recommendations as well as a breakdown of which type of stakeholder can be considered responsible for undertaking the given recommendations. This can be found in Chapter 4.

Table 1.0: The Six Recommendations

No.	IFS Component	Recommendation
1	Regulatory	• Review existing regulations and guidelines to ensure compatibility with Shariah guidelines • Develop a regulatory agency to monitor secondary markets and exchanges • Develop a legal infrastructure to foster growth of the Islamic financial system • Develop a specific disclosure guidelines for Islamic banks that increases transparency
2	Shariah	• Create an independent National Shariah Board to provide oversight and governance to internal and independent Shariah boards. • Develop seminar and training programs for Shariah scholars about Islamic banking operations and product development • Increase collaboration between Shariah scholars and Islamic bank management
3	Infrastructure	• Develop secondary markets for Islamic financial products • Develop exchanges for Islamic financial products • Adopt a national Islamic banking accounting standard • Revaluate liquidity management frameworks for national banks • Develop a specific liquidity framework for Islamic banks
4	Product and Services	• Increase range of Islamic products and services to satisfy the needs and demands of the Islamic finance and Islamic social finance client • Encourage innovation and adoption of new technology • Revaluate tax implementations for Islamic financial services and products
5	Initiatives	• Develop national campaigns to increase brand awareness of Islamic finance and social finance • Create a new campaign to focus on the positives of Islamic finance for non-Muslim investors • Encourage expansion of Islamic social finance in order to promote financial inclusion for the poor.
6	Talent Development	• Promote and sponsor academic research on Islamic finance and social finance • Increase training and academic programs specific to Islamic finance • Develop industry certifications for Islamic finance • Create scholarship and grant programs that sponsor individuals who are interested in working in the Islamic finance industry • Create Islamic finance industry trade associations • Develop and host conferences for Islamic finance industry members, researchers, and regulators to share ideas and collaborate on ways of growing and improving the industry

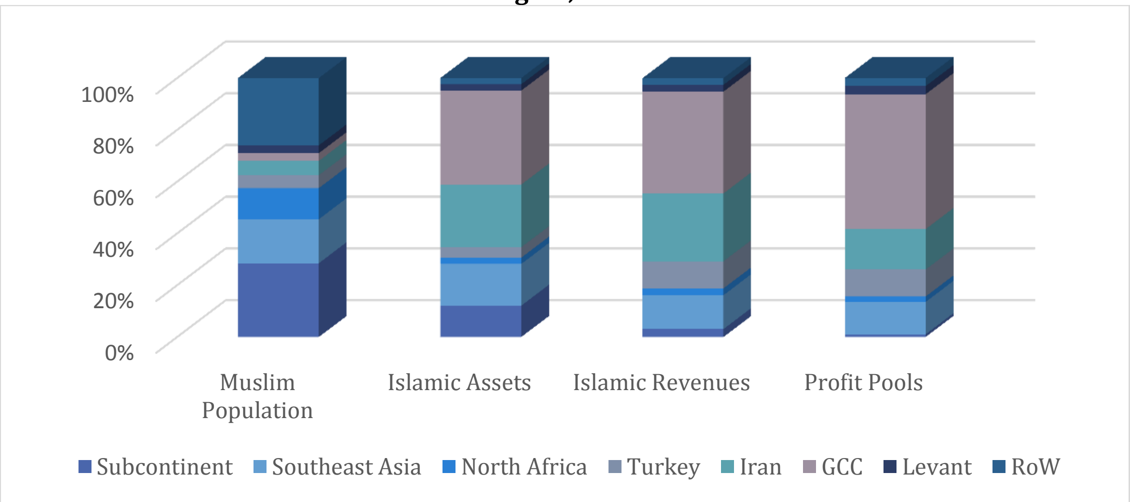
Chapter 1

1.1 Introduction

Since its modern inception in the 1950s, Islamic finance has been steadily growing in the Muslim world and has now been expanding into secular countries as well. Now with over 40 years experience, infrastructure, international and Shariah standards, research centers, and academic programs specializing in Islamic Finance are being established to support the growth and development of the Islamic Finance sector. Additionally, legal and regulatory frameworks, strategic plans, and initiatives are becoming more and more prevalent in order to build the Islamic finance sector to enable access to financial services for Muslims and individuals who are interested in investing in markets that follow best practice principles where interest is not charged, financial inclusion is a focus, and investments that benefit the community, especially the poor, are more favored over purely profitable investments. Figure 1.2 shows the significant developments in Islamic Finance that have occurred from before the 1970s until the present day.

The status of Islamic Finance in 2007 shown in Figure 1.1 indicates the opportunities present for expanding market share, with the largest amounts of the Muslim population residing in the Subcontinent and RoW region, yet comprising substantially smaller amounts of Islamic Assets, Islamic Revenues, and Profit Pools. The majority of the Islamic Assets, Islamic Revenues, and Profit Pools come from Iran and the GCC region, and a large amount from the Southeast Asia region. In 2007, the GCC region and Iran comprised 80 percent of global Islamic assets, yet only contained 6 percent of the global Muslim population. This reflects the growth opportunities present in Southeast Asia, North Africa, Turkey and the Subcontinent.

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

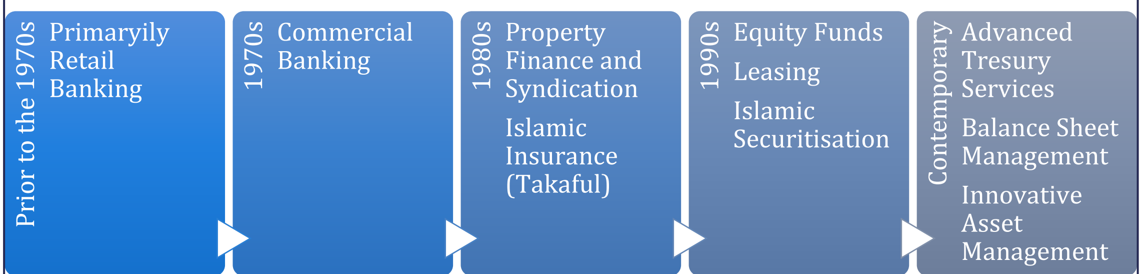


Source: The Next Chapter in Islamic Finance – Higher Rewards But Higher Risks (Oliver Wyman), Islamic Finance Global Financial Stability Report April 2010

Regional breakdown:

- Levant: Israel, Jordan, Lebanon, Palestine, Syria
- GCC: Qatar, Bahrain, Kuwait, UAE, Saudi Arabia, Oman
- North Africa: Algeria, Egypt, Libya, Mauritania, Morocco Tunisia, Sudan
- Southeast Asia: Cambodia, Laos, Thailand, Vietnam, Philippines, Brunei, East Timor, Indonesia, Malaysia, Singapore
- Subcontinent: India, Pakistan, Bangladesh, Bhutan, Nepal

Figure1.2: Significant Developments in Islamic Finance



Source: Islamic Finance Global Financial Stability Report April 2010

A 2015 report by Bank Negara Malaysia states that, "the growth in Islamic finance has attracted the attention of the conventional banking industry and non-OIC countries to tap into this growing market. The interest of conventional institutions in Islamic finance is part of its testament on its universal appeal and propositions, especially to tap wider investor and consumer base. Furthermore, ongoing efforts are being intensified at improving and harmonizing standards on regulatory, prudential, accounting, legal and human capital matters - setting the stage for a more cohesive and sustainable Islamic financial industry in the future."

It has been said that the practices and belief structure of Islamic Finance prevented the industry from incurring the full impact of the Global Financial Crisis (GFC). This came from the lack of investment in highly risky, speculative financial instruments that greatly contributed to the GFC. Despite this, the Islamic finance industry sector did incur some impact from the GFC, due to investment in foreign markets. There are measures needed in order to further prevent and shield the industry from the questionable practices present in other markets from investing in risky assets. This can be done by developing and implementing international and Shariah standards that optimize the efficiency of Islamic financial markets and also adhere to the rules set in Shariah laws and international regulations. Islamic financial instruments

already adhere to the same disclosure requirements as their conventional counterparts and, in some jurisdictions, adhere to additional disclosure requirements.
One of the vital components of the continued development of Islamic finance is the fostering of human capital, both in Islamic Finance staff and clientele. Research centers and academic institutions as well as training programs in Islamic financial institutions are working towards further training and educating the Islamic finance workforce and its clientele in order to have a competent and innovative work environment. Regulations that facilitate cross-border transactions are being emphasized to further the expansion of Islamic Financial Services. Initiatives focusing on building public awareness of the Islamic financial system to boost financial inclusion for the majority of the population in OIC countries and beyond is also needed.

There are tremendous opportunities in the Islamic Finance industry to provide economic empowerment for the poor, education and training for young adults entering the workforce and adults already in the workforce, investment in entrepreneurial endevors that will contribute to the community, and means for corporations and wealthy individuals to give back by helping the poor. Several countries have seen the potential that Islamic Finance has and have adopted Islamic banks into their jurisdictions. This expansion has helped grow the sector into several Muslim countries. Increased support from secular countries would help provide Muslim minorities in those countries access to Shariah-compliant financial products and services. Table 1.1 shows the potential and actual size of the Global Islamic Financial Services industry.

Table 1.1: Potential and Actual Size of the Global Islamic Financial Services Industry

	2009	2010	2011	2012	2013	2014
Potential size of the global Islamic financial services industry (USD trillion)	4.0	4.4	4.84	5.324	5.865	6.451
Actual size of the global Islamic financial services industry (USD trillion)	1.036	1.139	1.357	1.631	1.813	1.984
Size gap (USD trillion)	2.964	3.261	3.483	3.693	4.043	4.47
Growth in actual size of the global Islamic financial services industry (%)	26	9.9	19.1	20.2	12.3	9.3
Average growth rate between 2009-2014 (%)	-	-	-	-	-	16.1
Catch-up period based on 10% growth in potential size and 20% growth in actual size (years)	-	-	-	-	-	13.5
Catch-up period based on 10% growth in potential size and 16.1% growth in actual size (years)	-	-	-	-	-	22

Source: GIFR 2015

The potential size is defined as the assets under management (AUM) from institutions that provide Islamic financial services to everyone who wants access to Islamic financial services or to potential clients who would like access, but have opted out of utilizing financial services since there are no Islamic financial services available to them. The potential size of the Islamic Financial services industry is over three times greater than the actual size of the industry as of 2014. This reflects the need for the expansion of Islamic financial services to satisfy the demand by both Muslim and secular countries.

The 2015 Global Islamic Finance Report (GIFR) states that the demand for Islamic services from Muslim individuals is estimated to be over 90 percent. Furthermore, the demand from businesses owned by Muslims is estimated to be over 70 percent.

The 2015 GIFR also states these implications:

- **Purely Unmet Demand**
  The suppliers of financial services do not meet the full demand for Islamic financial services. This indicates a presence of purely unmet demand.

- **Involuntary Financial Exclusion**
  For the demand side, not all of the potential consumer base who demand Islamic financial services are actually obtaining access to these services and financial products. This indicates financial exclusion.

- **Voluntary Financial Exclusion**
  There are current Islamic financial services clients who are not fully satisfied with them due to religious reasons or due to certain business features of Islamic financial products.

Several initiatives are needed for Islamic financial institutions to rectify this unmet demand and financial exclusion. Infrastructure, brand promotion, governance, innovation, and human capital development will play major parts in fulfilling this demand and providing financial products and services to an untapped market. A key way of promoting the Islamic finance brand is to differentiate Islamic finance from conventional finance. Table 1.2 details the differences between those industries in terms of benefits, opportunities, and contributions.

Table 1.2: Conventional vs. Islamic Finance: Benefits, Opportunities, and Contributions

	Conventional Finance	Islamic Finance
Benefits	• **Real Economy** Provides access to capital as well as other financial services for firms, governments, non-profit organizations, and individuals on an interest-based, fee-based, and commission-based means of compensation. **Social Development** Provides a wide array of employment opportunities. There are numerous certifications, academic programs, and training programs present to cultivate human capital.	• **Real Economy** Provides access to capital as well as other financial services for firms, governments, non-profit organizations, and individuals on a fee-based or profit-sharing means of compensation. • **Social Development** There is a need for cultivating human capital to further expand the Islamic finance industry. Multiple academic and training programs and certifications have launched with additional ones in development.

Opportunities	• **Real Economy** There is a demand for socially responsible means of investment as well as additional ways for entrepreneurs to obtain funding for start-up companies, such as crowd funding, which has brought the creation of crowd funded securities. • **Social Development** With the mass utilization of the internet, conventional banks have expanded mobile banking, networking forums, and digital publications to provide additional value to their clients.	• **Real Economy** The focus of Islamic finance is to make financial services and products more accessible to the majority of the population. Islamic financial institutions provide funding to entrepreneurs through means of profit-sharing arrangements (Muharabah, Musharakah) • **Social Development** Islamic financial institutions and microfinance institutions look to build up individuals and businesses by providing further training specific to their needs in order to ensure their clients will succeed.
Contributions	• **Real Economy** Has created means for established firms and start-ups to obtain capital for pursuing projects. • **Social Development** Conventional banks have started providing additional services to entrepreneurs and clients in order to provide more value, including networking events, seminars, and workshops.	• **Real Economy** Provides funding and advising to businesses and entrepreneurs through Profit and Loss Sharing in order to pursue business endeavors. • **Social Development** Profit and Loss contracts offer services built into the contracts, such as advising and consulting, since the bank has a vested interest in the business venture doing well as they share the risk.

1.2 Analysis of Risk Matrices across Major Geographic Regions

This section will compare the risk of Islamic banks vs. conventional banks across three major geographic regions. These country jurisdictions are generally categorized into three major geographical regions: a) ASEAN region, b) MENA (Middle East and North Africa) region (which also includes GCC countries), and c) Sub-Saharan African countries.

1.2.1 ASEAN Region

Islamic banks listed in the BankScope database for the ASEAN region are from 6 different countries. Islamic banks in the data base are from Malaysia, Brunei Darussalam, Indonesia, Thailand, Singapore, and the Philippines. Based on the data availability, 37 Islamic banks from the mentioned 6 countries are selected for the analysis. The sample includes 37 Islamic banks with an average asset size of 6,783.786 million USD and Total Business volume of 7,618.017 million USD. Islamic banks in the region have on average, 168 branches and 3,060 employees.

Risk Matrices

Asset Quality Ratios

For the ASEAN region, the Asset Quality for the Islamic banks' loan portfolio comparable to that of their conventional counterparts on two of four ratios. Differences between Islamic and conventional the Loan Loss Res/Gross Loans and the Loan Loss Res / Impaired NCO Loans ratios are marginal. The average Loan Loss Res/Gross Loans ratio for both Islamic and conventional loans indicate banks hold a very quality portfolio. The starkest contrast is seen with the NCO / Net Income before loan loss. The difference between Islamic and conventional banks indicate conventional banks hold better loan portfolios because they seem to receive more income before the charge-off of a loan.

Capital Adequacy Ratios

Islamic banks in the ASEAN region suffer from lower asset quality compared to their conventional counterparts, however, higher Capital Adequacy ratios imply that the Islamic banks keep higher cushions in terms of capital adequacy. All four Capital Adequacy Ratios show a clear trend, Islamic banks hold more capital compared to conventional counterparts.

Operational Efficiency Ratios

In general, higher operating ratios represent a lower cost of funds, higher efficiency, and higher yields on equity and assets. Low Net Interest Margins for the Islamic banks and conventional banks represent cheaper sources of funding. We see that there is a marginal difference for many of the operational efficiency ratios for Islamic and conventional banks in this region. The Returns On Avg Equity (ROAE) are higher for the Islamic banks. However, in general, the conventional banks provide higher dividends.

Liquidity Ratios

Interbank Ratios are lower than 100% for Islamic and conventional banks, which indicates that Islamic banks are net borrowers. However, ratios for Net Loans / Cust & ST Funding, Net Assets / Tot Dep & Bor. And Net loans / Total Assets are marginally different. This indicates that Islamic banks hold comparable liquidity to their conventional counterparts.

1.2.2 MENA Region

Islamic banks listed in the BankScope database from the MENA region are from 13 different countries. Islamic banks in the data base are from Saudi Arabia, Kuwait, UAE, Qatar, Bahrain, Iran, Egypt, Jordon, Syria, Iraq, Oman, Palestine, and Lebanon. Based on the data availability, 41 Islamic banks from the mentioned 13 countries are selected for the analysis. The sample includes 41 Islamic banks with an average asset size of 8,539.273 million USD and Total Business volume of 10,117.568 million USD. Islamic banks in the region have on, an average, 49 branches and 2,133 employees.

Risk Matrices

Asset Quality Ratios

For the MENA region the Average Loan Loss Res/Gross Loans ratio of Islamic banks is comparable to their conventional counterparts. In general, Islamic banks have comparable asset quality ratios, compared to their conventional counterparts. The only significant difference between the Islamic banks and conventional banks is with Loan Loss Prov / Net Int Rev, for Islamic banks 37.64% and conventional banks 17.99%. This could indicate higher loan portfolios for Islamic banks in the MENA region.

Capital Adequacy Ratios

Higher capital adequacy ratios suggest Islamic banks show that they keep higher equity cushions to cover risk exposure and avoid the capital adequacy problem. The data shows the four capital adequacy ratios are higher for the Islamic banks compared to those of the conventional banks. Most notably, the Equity / Liabilities ratio is much higher for Islamic banks, 73.98% for Islamic banks, compared to 16.95% for their conventional bank counterparts.

Operational Efficiency Ratios

In general, higher operating ratios represent a lower cost of funds, higher efficiency, and higher yields on equity and assets. On average, most operational efficiency ratios are similar across Islamic and conventional banks in the MENA region. Non Int Exp / Avg Assets ratio and Return On Avg Equity (ROAE) are higher for Islamic banks. On average, Islamic banks in the MENA region pay out more dividends, 52.96%, compared to 34.54% for Conventional banks.

Liquidity Ratios

Interbank Ratios of greater than 100 indicate the bank is a net lender, rather than a borrower. Interbank ratios for the Islamic banks are lower than conventional banks but remain above 100. This seems to indicate that the Islamic banks are lenders in the interbank market, but not as strong as their conventional counterparts in the region. Islamic banks also have higher Net Loans / Tot Dep & Bor and Liquid Assets / Tot Dep & Bor. The higher Liquid Assets / Tot Dep & Bor ratio indicates that conventional banks tend to hold more liquid assets in their portfolio compared to conventional banks in the region. Overall liquidity of Islamic banks in the MENA region are comparable to conventional banks.

1.2.3 Sub-Sahara Africa Region

Only the Islamic banks from Sudan and Mauritania are listed in the BankScope database. Based on data availability, 8 Islamic banks from these two countries are selected for this analysis. Of the 8 Banks, 7 are from Sudan. Only Shariah compliant financial services are provided in Sudan. However, for comparison, banks from Sudan will be compared against other banks of similar asset size in the Sub-Sahara Africa Region. Due to lack of sufficient data, Islamic banks from Mauritania are not included in the analysis.

The sample includes 7 Islamic banks from Sudan, with an average asset size of 832.954 million USD and average Total Business volume of 1,042.669 million USD. Islamic banks in the region have, on average, 19 branches and 552 employees.

Risk Matrices

Asset Quality Ratios

For the Sub-Saharan region the only Islamic banks considered are from Sudan because only Shariah compliant banking is provided. Islamic banks in Sudan exhibit an average Loan Loss Res/Gross Loans ratio of 2.71% and a Loan Loss Res / Impaired Loans ratio of 41.63%, which is generally lower than other peer Islamic banks in other geographic areas.

Capital Adequacy Ratios

In general, the Islamic banks in Sudan maintain a significant cushion to cover their risk exposure and possibly capital adequacy problem. Most of the capital ratios are higher than other peer Islamic banks in other regions. The Islamic banks maintain a higher level of capital adequacy than both conventional institutions in the region and many other institutions around the globe. Higher Equity / Net Loans reflect a higher cushion to absorb losses on the loan book.

Operational Efficiency Ratios

In general, higher operating ratios represent lower cost of funds, higher efficiency and higher yields on equity and assets. Although Islamic banks in Sudan do not exhibit abnormally high Net Interest Margins their ROAEs are at an adequate level. Islamic banks in this region provide lower dividend payouts compared with their peers in the region, but their dividend payout level is on par with Islamic peer institutions in other regions.

Liquidity Ratios

Islamic banks in Sudan keep a significant portion of their portfolio invested in liquid assets. The high ratio of Liquid Assets / Tot Dep & Bor reflects higher liquidity. However, their low Interbank Ratio indicates that banks in Sudan are net borrowers.

1.3 Key Features of Commonly used 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. These types of products will be discussed in this section in relation to their key trends, recent developments, and potential for growth.

The Key Islamic Finance products are:

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

Box 1: The Features of Islamic Finance

Islamic finance is the only financial system in the world today that is based on the teachings of a major religion, and it proves to be increasingly attractive for secular Muslims and non-Muslims as well. While the conventional financial industry has been suffering a tremendous loss of reputation, due to its obvious shortcomings and its harmful impact on economies worldwide, a Shariah-compliant financial system appears to be profitable, viable, fair, and a clear survivor of the recent global debacle.

Islamic finance represents a fundamental departure from conventional interest-based and speculative practices, as it relies completely on real economic transactions, such as trade, investment based on profit-sharing, and other ways of doing business. Rather than treating money as a commodity (as in capitalism), in Islam, money is no more than a measure of value.

Many of the features of Islamic finance are also found in other religions and ethical systems. For instance, the prohibition of interest is present in all Abrahamic faiths: Christianity, Islam, and Judaism. Interest was limited in Hindu law, the Code of Hammurabi, the Magna Carta, and Roman law, as well as in many US States until 1981. The rejection of financial speculation, which is detached from real economies, is shared by many observers and consumers in non-Islamic, Western countries. There is a significant overlap between Islamic principles and socially responsible investment (SRI), given that Islam preaches social justice, ecology, kindness, and what is called nowadays sustainability. All this makes Islamic finance a topic of truly global interest and relevance, as there is the potential for introducing a financial system which is both ethical and stable at the same time.

It must however be noted that the reality of Islamic financial systems nowadays is not yet close enough to those noble ideals. In several cases, the basic rules, such as the prohibition of riba (interest) have been circumvented, and pseudo-Islamic financial products were created, which were actually mere imitations of conventional financial products. By way of example, in the past there had been some types of sukuk (Islamic bonds), which exactly mimicked conventional interest-based bonds, and even instruments that resembled financial derivatives in an undesirable way. Pseudo-Islamic financial products strike at the foundations of Islamic finance, and in fact there is a growing standardization of financial instruments and practices, which will avoid such a misuse of traditional Islamic contracts.

Source: Islamic Capital Markets: Products and Strategies by M. Kabir Hassan and Michael Mahlknecht

1.3.1 Islamic Indices

Islamic Indices have grown substantially since the inception of the first Islamic indices in 1999. There are multiple new indices that have launched, which have expanded access to Islamic Capital markets on a global scale as well as strengthened the global market infrastructure. These indices have provided valuable information to Islamic fund managers, who have also benefited from the Shariah screening and expansion of securities that are Shariah compliant. Investors that are looking for alternative portfolio exposures as well as ethical products have also benefited from these indices. Table 1.3 provides a list of major Islamic Capital Market indices.

There is an increased interest in Islamic financial services in secular countries, such as Australia, where the Thomson Reuters Crescent Wealth Islamic Australia Index has been created in order to NASDAQ-100 and OMX Stockholm Benchmark indexes to customers interested in maintaining an Islamic investment portfolio.

Table 1.3: Islamic Indices Providers for Islamic Capital Markets

<table>
<tr><th>Indices Name</th><th>Details</th></tr>
<tr><td>Dow Jones Islamic Market Indices</td><td>Country Indices
track Shariah-compliant securities in 69 countries across both developed and emerging markets
Example: DJIM Canada, DJIM China, DJIM Kuwait, DJIM U.K., etc.
Global/Regional Indices
include regional, industry sector and market capitalization indices, as well as specialized indices and custom measures
Example: DJIM Asia Pacific, DJIM GCC, DJIM Europe, DJIM Emerging Markets
Strategy/Thematic Indices
Example: DJIM BRC, DJIM Global Finance and Takaful.</td></tr>
<tr><td>S&P Shariah Indices</td><td>Major Indices
In 2006, S&P applied Shariah screens to three major indices – the S&P 500, the S&P Europe 350 and the S&P Japan 500
Regional Indices
In 2007, S&P followed with the S&P GCC Shariah and the S&P Pan Asia Shariah Indices, to cater for the demand for Shariah product benchmarks for those regions
Other regional indices: Europe 350 Shariah, Global BMI Shariah, BRIC Shariah.
Global Indices
In 2008, S&P reviewed S&P Global Broad Market Index (BMI) Equity Indices for Shariah compliance and created the S&P Global BMI Shariah index that includes 6,000 companies in 10 sectors and 47 countries.
Market Cap Indices
Example: IFCI Large-Mid Cap Shariah, 500 Shariah, etc.
Sector Indices
Global Healthcare Shariah, Global Property Shariah, etc.</td></tr>
<tr><td>MSCI Global Islamic Indices</td><td>MSCI began its Islamic indices series in 2007. Later, the indices were developed to cover over 50 developed and emerging countries and over 50 regions such as the GCC countries and Arabian markets
Developed Market Indices: EU Islamic, World Islamic, North America Islamic, etc.
Emerging Market Indices: BRIC Islamic, EM Asia Islamic, EM Eastern Europe Islamic, etc.
Frontier Market Indices: FM Africa Islamic, FM CEEC Islamic, etc.
GCC and Arabian Market Indices: Arabian Markets Islamic, GCC Countries Domestic Islamic, etc.</td></tr>
<tr><td>FTSE Global Islamic Indices</td><td>FTSE introduced its Shariah indices in 2006, starting with the FTSE Global Shariah Index Series, screened by Yasaar Shariah scholars. Later, three Islamic indices were launched in August 2006.
Country Indices</td></tr>
</table>

<table>
<tr><th>Indices Name</th><th>Details</th></tr>
<tr><td></td><td>Austria Islamic, Germany Islamic, Singapore Islamic, etc.
Global/Regional indices
Global Islamic, Europe Islamic, Americas Islamic, Pacific Basin Islamic, etc.
Industry Indices
Physical Industrial Metals, etc.</td></tr>
<tr><td>Thomson Reuters IdealRatings Islamic Indices</td><td>IdealRatings has been providing Shariah fund management services for financial institutions since 2006. Thomson Reuters/IdealRatings indices are characterized by quarterly, research-based Shariah compliance screening performed by IdealRatings.
Thomson Reuters BPA Malaysia Bond and Sukuk Indices
Thomson Reuters Indices and Bond Pricing Agency Malaysia have partnered to provide the most comprehensive range of Malaysian Fixed Income and Sukuk benchmarks available.
The new family of indices include 108 Malaysian Ringgit Sukuk and bond indices comprising 36 Thomson Reuters-BPAM Malaysian Sukuk Indices, 36 Thomson Reuters-BPAM Malaysian Bond Indices and 36 Thomson Reuters-BPAM All Bond and Sukuk Indices covering 778 issues.
The Indices cover six bond classes, are archived back to 2007 and have total market capitalization of MYR 583,624 million (US$182 billion).
The indice has highly liquid index variants which feature only the top 5 bonds by volume are also available, making them of ideal for use as investment products.
Thomson Reuters Global Sukuk Index
The Thomson Reuters Global Sukuk Index is an independent and transparent benchmark for investors seeking exposure to sukuk (Shariah-compliant) fixed-income investments, to be used to monitor the performance of the sukuk market.
Pricing evaluations are produced using two primary methodologies: Model and Dollar Pricing.
Most issues priced by the model approach incorporate a benchmark for each market, credit spreads and other variables.
Dollar pricing is applied mainly to issues that are unique in their structure or to high –yield securities particularly when the issuer of those securities has defaulted on a bond or has fallen below investment grade.
All issues are individually priced and inputs include quotes from the primary dealer and other market makers, and traded prices in the security.
The index is dollar denominated and rules for inclusion will be sukuk with amount outstanding of not less than $100 million and above.
Custom Islamic Indices: Thomson Reuters Crescent Wealth Islamic Australia Index
Thomson Reuters and Crescent Wealth, the Australian Islamic investment manager, have launched an Islamic investment</td></tr>
</table>

Indices Name	Details
	index for Australia to help open up this resource-rich market to Islamic finance investors globally. ○ The Thomson Reuters Crescent Wealth Islamic Australia Index is the first benchmark index to screen ASX-listed companies for compliance with Islamic investment principles using Thomson Reuters unique research-based approach.
Nasdaq Islamic Index Services & Sharia Compliant Indices	• The EDBIZ-NASDAQ OMX Sharia Index Family brings the renowned and widely-followed NASDAQ-100 and OMX Stockholm Benchmark indexes to customers interested in maintaining an Islamic investment portfolio. The indexes are meticulously assessed and audited for Sharia compliance by an independent Sharia advisor, Edbiz Consulting. • The Edbiz OMX Stockholm Benchmark Sharia Index (OMXSBSHARIA) is designed to track the performance of securities of the OMX Stockholm Benchmark Index (OMXSB) that meet the Sharia requirements.

Source: Risk Management in Islamic Financial Instruments, Thomson Reuters, Nasdaq OMX

1.3.2 Islamic Banking

The largest percentage of banking assets comes from the MENA countries, while Asia has the largest percentage of sukuk outstanding. The GCC countries have the highest percentage of Islamic Funds Assets and the GCC countries have the highest percentage of takaful contributions. The composition of Islamic Finance Segments is concentrated primarily in banking assets, with sukuk outstanding second, followed by Islamic Funds Assets, and Takaful Contributions. The proportion of takaful contributions in comparison with the other Islamic finance segments is quite low and leaves substantial opportunity for growth and expansion. Table 1.4 details the breakdown of Islamic finance segments by region.

Table 1.4: Breakdown of Islamic Finance Segments by Region (USD billion, 2014 YTD)

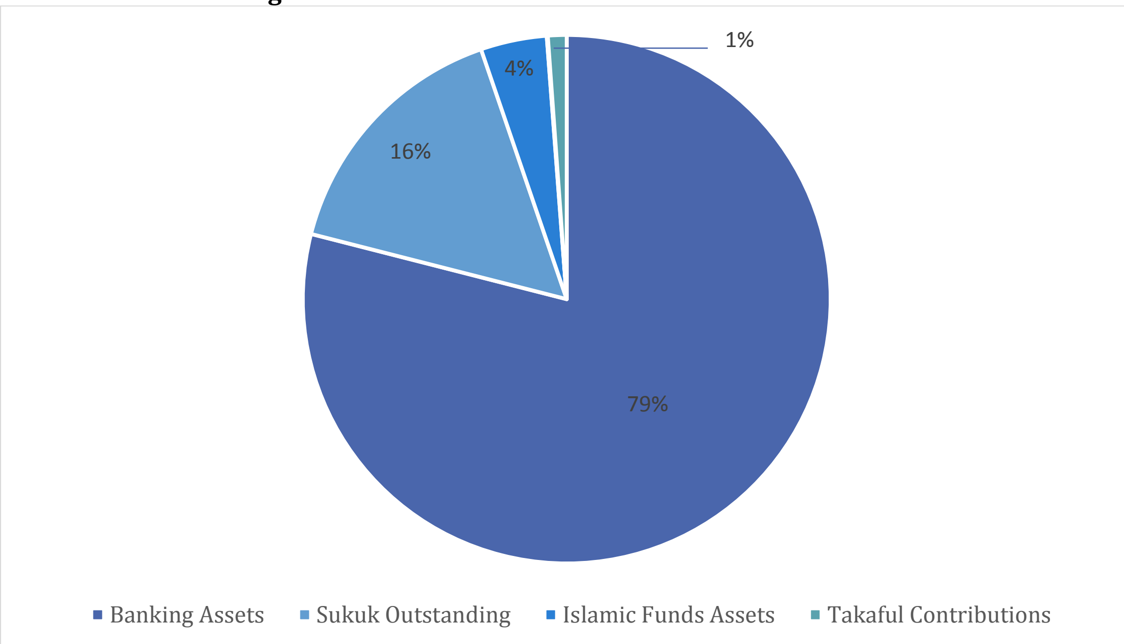
Region	Banking Assets	Sukuk Outstanding	Islamic Funds Assets	Takaful Contributions
Asia	203.8	188.4	23.2	3.9
GCC	564.2	95.5	33.5	9.0
MENA (exc. GCC)	633.7	0.1	0.3	7.7
Sub-Saharan Africa	20.1	1.3	1.8	0.6
Others	54.4	9.4	17.0	0.3
Total	1476.2	294.7	75.8	21.4

Source: IFSB 2015 Stability Report

Figure 1.3 shows the breakdown of global Islamic finance assets by asset type with the majority in Islamic banking assets at 79 percent, followed by sukuk outstanding at 16 percent.

There is still great potential increasing concentration of both assets of Islamic funds and takaful contributions, which comprises just 4 percent and 1 percent respectively.

Figure 1.3: Global Islamic Finance Assets Breakdown



Source: IFSB 2015 Stability Report

Box 2: The Fundamental Differences between Islamic Banks and Conventional Banks

Differences between an Islamic bank and a conventional bank can include their ultimate goals. An Islamic bank aims to follow the social requirements as per the Qur'an. The relationship an Islamic bank has with their clients is also different. They may offer finance via equity relationships in projects.

An Islamic bank is able to undertake direct investments and participate in the management of projects. Indeed, this process can potentially help people even if they reside in developing countries with limited funds but with good projects and ideas to obtain finance. Another common financing technique is the purchase and resale agreement where the Islamic bank effectively purchases the product and then resells it to the client with a specific repayment schedule including a set mark-up.

The later type of transaction is less risky than conventional loans, however equity financing is much more risky because of the potential for the Islamic bank to also share in losses from the project. Islamic bank operations have often been limited in size within most financial systems. Hence, when comparing the performance of these banks, there are few peer banks within a particular country. So although a number of single country studies exist (e.g. Hassan, 1999; Sarker and Hassan, 2005; Ahmad and Hassan, 2005 examining Bangladesh), there are advantages in examining Islamic bank performance across country borders. Efficiency relates to how well a bank performs. During the 1990s especially there was a fundamental push for banks to lower costs. Hence measures of 'cost' efficiency were seen as important. Regulation and other operational aspects of Islamic banking also influence performance.

Source: 'Operational efficiency and performance of Islamic banks,' as chapter 7 in M.K. Hassan and Mervyn Lewis (editors), Handbook of Islamic Banking

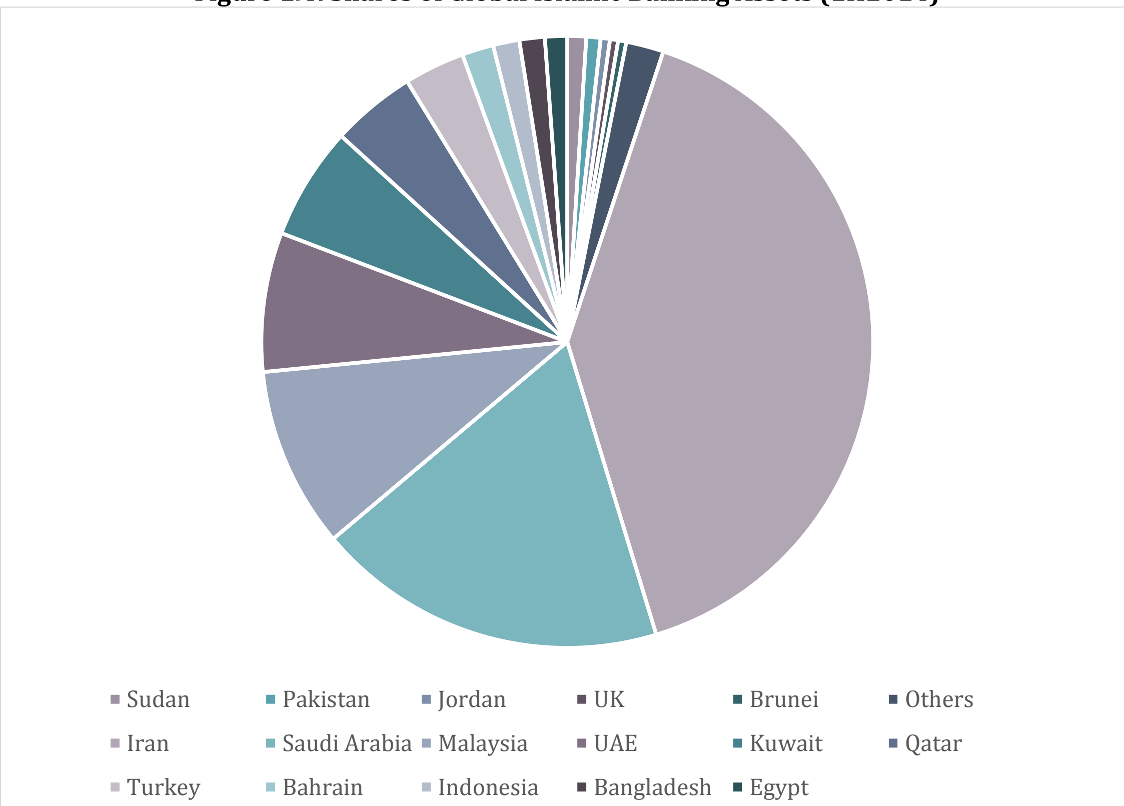
Box 3: The Emergence of Islamic Banking

Islamic Banking is an interest-free banking system which emerged in the global scene barely four decades ago. The definition of Islamic banking system is essentially any banking system that complies with the economic value system of Islam. The Islamic banking business has emerged as an ethical banking system which is primarily meant to cater for the interests of about one-fourth of the world population.

Islamic banks engage in three major services: free services, services rendered by banks on fixed exchange, commission or discount, and creation and development of funds. The development of Islamic banking system has demonstrated its potentiality of being used as a viable global financial intermediary. The crystallization of the Islamic banking system in the 21st century has made it a force to be reckoned with to avert any future global economic crunch.

Source: "The Emergence and Development of Islamic Banking," Islamic Finance: Instruments and Markets

Figure 1.4: Shares of Global Islamic Banking Assets (1H2014)



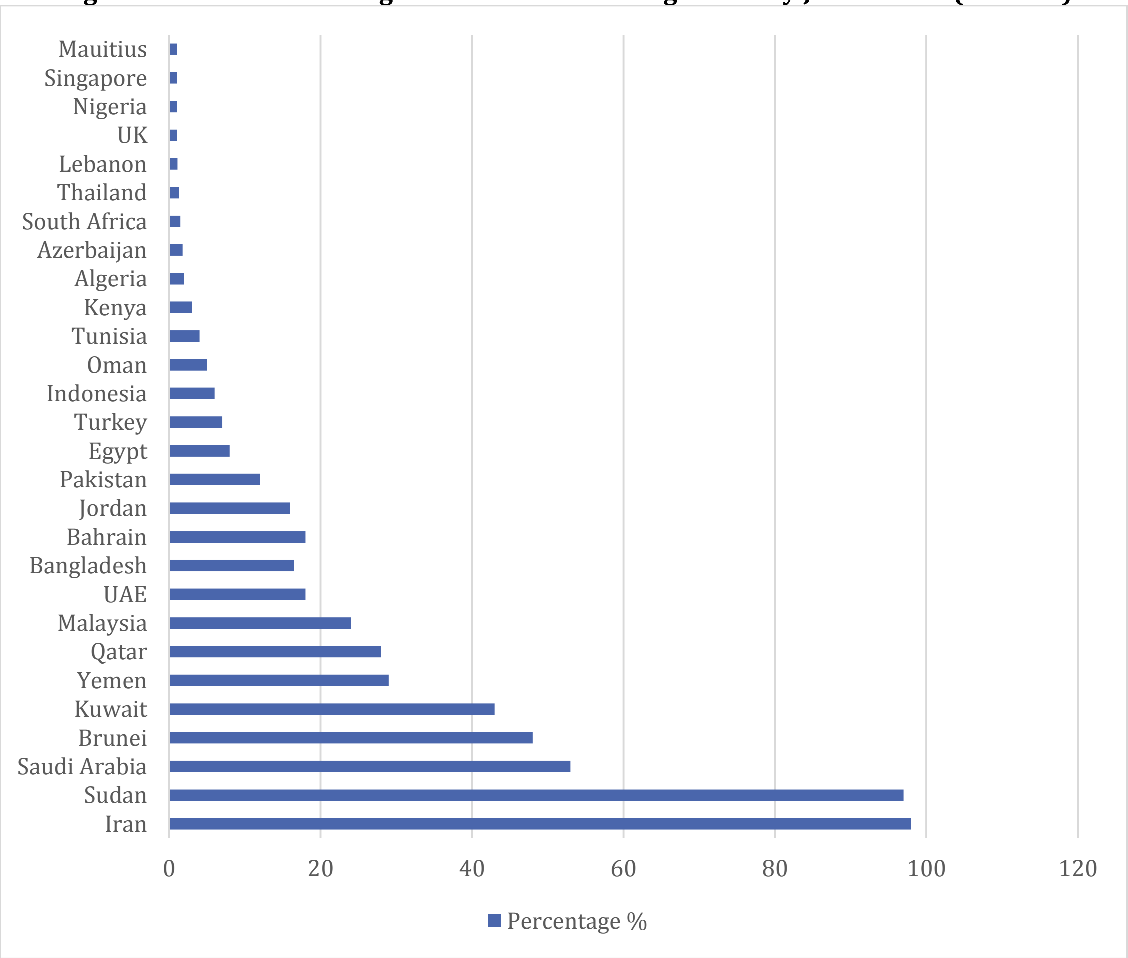
Source: IFSB 2015 Stability Report

Figure 1.4 shows the Islamic banking shares of global banking assets, with Iran emerging as a leader in that assessment. Figure 1.5 shows the breakdown of the Islamic banking shares in total banking assets by each jurisdiction. Iran had the largest amount with 40.21 percent, followed by Saudi Arabia at 18.57 percent. Malaysia shares are 9.56 percent and UAE shares are 7.36 percent.

Key Trends

- The Islamic banking sector dominates the Islamic finance industry, being the largest segment of the global Islamic finance industry.
- Islamic finance assets are in full-fledged Islamic banks, subsidiaries, and windows. The assets total to approximately USD1.48 trillion at 1H2014.
- Expansion of the sector has been 16.89 percent from 2008 to 2013 and has increased by 16 percent in 2013 year on year.
- The majority of Islamic bank funding comes from deposits.
- The limited access to liquidity management tools still remains an issue. Most Islamic banks' financing-to-deposit ratios were under 90 percent and on average, the short-term asset liability ratio was approximately 80 percent of the liabilities payable in a time period of 90 days.

Figure 1.5: Islamic Banking Share in Total Banking Assets by Jurisdiction (1H2014)



Source: IFSB 2015 Stability Report

Recent Developments

- There have been improvements with Islamic bank's liquidity positions due to regulatory reform.

- Malaysia's Islamic Financial Services Act took effect in 30 June 2014. This acts has provided a foundation for the Islamic banking system that brings a shift to a regulatory framework that reflects the specifications of the different types of Shariah contracts.

- Qatar is developing a deposit insurance framework that will include a Shariah-compliant variant as part of the strategic plan to modernize Qatar's financial sector

- Turkey established Interest-Free Finance Coordination Board in December 2015 to further develop interest free finance in the country. Ziraat Participation Bank, the first state owned participation bank, has started its operations in May 2015. Vakıf Participation Bank is the latest participation bank which started its operations in February 2016. These stated banks are some of the largest banks in Turkey and will contribute to the expansion of Islamic financial services in the country.

- Plans are being developed to create the Eurozone's first full-fledged Islamic bank, which will be headquartered in Luxembourg. The bank will provide retail, corporate, and private banking services in the area and plans are to establish branches in Belgium, France, Germany, and The Netherlands.

- In the Sub-Saharan Africa, Burkina Faso will open the first Islamic banking window in 2015-16.

Potential of Islamic Banking

- Assets in the Islamic Banking industry are heavily concentrated in the Middle East and multiple countries in Asia. The ten largest Islamic Banking jurisdictions comprise close to 94 percent of global Islamic banking assets.

- The Islamic Banking industry is expanding into new countries in Africa and Europe. This has the potential to contribute to the growth in global Islamic banking assets and reduce the concentration of Islamic banking assets in certain countries.

Box 4: Profit and Loss Sharing in Islamic Finance

The most salient values of the Islamic financial system are fairness and socio-economic justice. The exuberance of Islam's uncompromising commitment towards the well-being of humankind goes beyond its caring for existing generations to ensuring stainable future for generations to come. This is evident by giving utmost priority to the environment and preserving earth's valuable - yet limited endowments and resources, and by limiting public borrowings to available resources hence freeing future generations from the burden of debt. The Islamic system of production and finance, which is based on profit-and-loss sharing (PLS), is considered to be more efficient and equitable in distribution of wealth and income.

Allocation of funds under risk sharing will be based on the viability and expected profitability of the proposed entrepreneurial undertakings rather than on the creditworthiness of competing entrepreneurs. Furthermore, risk sharing offers both entrepreneurs and investors incentives to be truly engaged in productive economic activities, wherein entrepreneurs will be encouraged by the prospect of seeing their ideas transformed into business entities, and financers will be obliged to assess the risk involved more cautiously, and effectively monitor the use of funds by the entrepreneurs. The apposite implementation of such partnership contracts increases the likelihood of business success, injects more discipline in financial market by reducing excessive lending, and ultimately will have positive implications for the socio-economic well-being of society at large.

Source: Islamic Financial System: Risk Management and Social Justice," ISRA International Journal of Finance, Volume1, Issue 1, December 2009: 33-58

Box 5: Regulation in Islamic Banking

The Basel II framework is based on minimum capital requirements, a supervisory review process, and the effective use of market discipline. The new framework aligns capital adequacy with banking risks and provides incentive for financial institutions to enhance risk management and their system of internal controls. Like conventional banks, Islamic banks have to operate under different regulatory regimes. The still diverse views on Islamic banking and finance operations among the regulatory agencies of different countries amplify the difficulties in assessing the overall performance of the international Islamic banks. In light of increased financial innovation and diversity of instruments offered in Islamic finance, the need to improve transparency of bank operations is particularly relevant for Islamic banks.

While product diversity is important in maintaining the competitiveness of Islamic banks, it also requires increased transparency and disclosure to improve the understanding of markets and regulatory agencies. Governance of Islamic banks is made more complex by the need for these banks to meet a set of ethical and financial standards that are defined by the Shari'ah and the nature of the financial contracts that are used by banks to mobilize deposits. Effective transparency in this area will greatly enhance the credibility of Islamic banks and reinforce the confidence of the depositors and investors.

Source: "Basel II and Islamic Banking Regulation," American Journal of Islamic Social Sciences (AJISS), Volume 27

1.3.3 Islamic Capital Market

The Islamic Capital Market (ICM) refers to the market where activities are carried out in ways which do not conflict with the principles of Islam. The ICM represents an assertion of religious law in capital market transactions where the market is free from prohibited activities and elements such as riba, maisir and gharar.

Islamic Capital Markets are broadly comprised of three main sectors:

1. The Islamic equities market (facilitated by Shariah-compliant indice availability)
2. The Sukuk, or Islamic bond market
3. The Islamic funds market

Source: Bursa Malaysia, 2015 IFSB Financial Services Industry Stability Report

Key Trends

- The Sharia Interbank Money Market (PUAS) was launched in 2000 by the Bank Indonesia (BI), the Indonesian central bank.
- The Bank Indonesia Wadiah Certificate (SWBI) was also launched in order to utilize liquidity management and as a means of investment.
- In 2008, the Sharia Bank Indonesia Certificate (SBIS) by Ju'alah contract amended the Bank Indonesia Wadiah Certificate. This updated certificate was utilized for Bank Indonesia bilateral transactions.

- In 2008, Bank Indonesia also launched Indonesia's sovereign sukuk (SBSN) and SBIS REPO which is specifically for Islamic banks. The Jakarta Futures Exchange (JFX) also facilitates a platform for trading commodities, including cocoa and coffee.

Box 6: Speculation in the Islamic Capital Market

One major property of the stock exchange upheld by most economists is the capacity to ensure a liquid investment market. The strong appeal of a liquid investment market cannot be exaggerated, but excessive speculation is viewed as a harmful and non-productive use of a society's scarce resources. The paramount importance of economic information in the Islamic jurist theory of contracts underpins the strict prohibition of gambling, and justifies why the issue of stock market speculation is a major theme in the writings of Islamic economists. A Normative Islamic Stock Exchange (NISE) is characterized as a purely equity-based market, free from interest rate financing and carefully guarded against gharar.

The interest-free property is the core feature of Islamic finance, whereas guarding against gharar makes up for NISE's informational efficiency. Gharar is the jurist term for inadequate market information or uncertainty about exchange objects, particularly when no practical obstacles stand in the way of furnishing full information to the contracting parties about the objects of exchange. Some gharar is, therefore, tolerable because it often proves impracticable to totally eliminate uncertainty from exchange contracts. But when deliberately embodied in the contract, gharar becomes sufficiently serious to warrant strict prohibition, as exemplified by the classical jurist cases of selling birds in the sky or fish in the sea (Al-Dharir, 1967; Saati, 2003).

Gambling is a special case of serious gharar. Despite the obvious relevance to the topic in Islam, there is only a limited literature to date on the relationship between the efficient market hypothesis (that asset prices in financial markets reflect all available information) and speculative bubbles. Hassan and Tag El-Din (2005) is only exception. Tag El-Din (1996) and Kia (2001) argue against the inefficiency created by growing speculative activities in the stock markets, and they both discuss the need for an optimal level of speculation required for liquidity and efficiency of the stock market.

Tag El-Din suggests a publicly traded company must hire professional portfolio managers who will determine the fundamental value of company's stock on a daily basis, and the investors will determine the equilibrium prices in exchange using this fundamental value as benchmark. There must be restrictions on the trading activities of large and small investors, and small investors should be allowed to trade in open-ended funds. Kia also suggests that the government policy should ensure that investors have complete knowledge of stock market mechanism through training. He also recommends a tax on short-term stock trading activities.

Source: Tag El-Din, Seif El-Din and M.K. Hassan, 'Islam and speculation in the stock exchange,' as Chapter 15 in M.K. Hassan and Mervyn Lewis (editors), Handbook of Islamic Banking

Recent Developments

- The major development in terms of liquidity management was the establishment of the International Islamic Liquidity Management Corporation (IILM) in 2011. The organization is based In Kuala Lumpur in order to provide cross-border liquidity management services to Institutions Offering Islamic financial services (IIFS). The IILM is owned by 11 central banks along with the IDB and its subsidiary ICD (Islamic Corporation for the Development of the Private Sector), and had its first issuance of sukuk in 2013.
- In 2015, The International Islamic Liquidity Management Corporation (the IILM) announced that it has successfully reissued USD490 million 3-month tenor sukuk priced at a 0.58100% profit rate. 50% of respondents stated that there are interbank

money market instruments that are Shariah-compliant. There are IIFS liquidity management facilities in UAE, Bahrain, Brunei and Sudan, but they consist mainly of bilateral transactions that occur with their respective central banks. These bilateral transactions may help with issues with liquidity, but price discovery is deemed impossible due to the lack of multiple players as well as the lack of market trading. Because of this, IIFS are unable to establish the actual costs of funds. In these circumstances, conventional market interest rates are utilized in order to gauge what the appropriate profits rates are for the IIFS transactions.

- Islamic hedging instruments are making considerable progress since 2004, notably in both Malaysia and the GCC region. Despite this, there are still issues with Shariah-compliance. New products launched in this market include Islamic Profit Rate Swaps (IPRS) for managing mark-up rate risks due to duration gaps and wa'ad-based hedging products for currency risk management, as well as Islamic FX swaps and cross-currency swaps. Wa'ad-based hedging products are used mainly by Shariah-sensitive importers and exporters for risk management.

- The IIFM's ISDA/IIFM Taḥawwut Master Agreement has heavily influenced the growth in the hedging market due to the agreement's simplified cross currency swaps and simplified documentation. The standardization of hedging instruments, such as the profit rate swap, Islamic cross currency swap and FX forward, interbank Commodity Murabahạh, investment Wakālah, and profit rate swap by IIFM has had a substantial impact on building awareness of the utilization of hedging instruments.

- There are also multiple Shariah-structured products that consist of embedded options or other hedging features that IIFS is not offering in several markets. Certain types of Sukuk include hedging features. Since the majority of these products are over-the-counter (OTC), there is limited trading volume data of these instruments.

Potential of Islamic Capital Market

- Islamic Capital Markets have the potential to strengthen liquidity management for Islamic banks as well as Islamic firms.
- Further development of Islamic financial products that will enable efficient risk management systems could be included in Islamic Capital Markets.

Box 7: Innovation in the Islamic Capital Market

Innovation and product enhancements in business and finance are an important aspect for the development and growing of Islamic finance industry. However the flexibility provided by Shariah in product development should be understood within the norm of Shariah rules, principles and framework. The process in governed by very prominent parameters and standards to ensure consistency in product offered to the market space, whether the products are offered for banking, Takaful or Islamic capital market. There is Shariah frameworks that govern the Islamic finance industry, in additional to that it should be distinguish between product Shariah base product and Shariah compliance product, each category has its criteria and feature, and subject to particular process in product development and approval. For the product of securities there are different methods adopted in the Shariah screening process that is considered by different index provider.

Source: "The Shariah Process in Product Development and Approval in ICM," Chapter 2 in Islamic Capital Markets: Products and Strategies by Ahcene Lahsasna and M. Kabir Hassan

1.3.4 Sukuk (Islamic bonds)

In 2014, issuances of sovereign sukuk occurred in the United Kingdom, Luxembourg, South Africa, and Hong Kong. The sukuk industry is currently perceived as a niche market in the global financial services industry and has yet to be established as a globally recognized industry. This could be due to lack of human capital and leadership. In 2014, sukuk comprised 15 percent of Islamic Finance Assets, while Islamic Banking comprised 75 percent.

Key Trends

- The Sukuk market segment has grown faster than any other segment in the Islamic Financial Services Industry. In 2014, Malaysia accounted for almost a third of the Sukuk issuances.
- The Sukuk market has shown much resiliency, with a default rate of only 0.6 percent from the total issuance of Sukuk tranches from 1990 to the end of 2014. This could be due to approximately 80 percent of the Sukuk issuances being sovereign, which is debt issued by the government.
- Trends in sukuk indicate a reduction in risk-sharing models and a movement to debt-creating contracts. Fewer than 7 percent of total new Sukuk issued in Quarters 1 through 3 of the year 2014 were created based on risk-sharing contracts (Mudarabah or Musharakah)
- After the Global Financial Crisis, the sukuk market has been used increasingly by sovereign and government-related issuers. Since 2009, these types of issuers comprised an average of 80 percent of the annual volume of sukuk. This has grown from the approximate average volume of 29.4 percent from 2004 to 2008.

Recent Developments

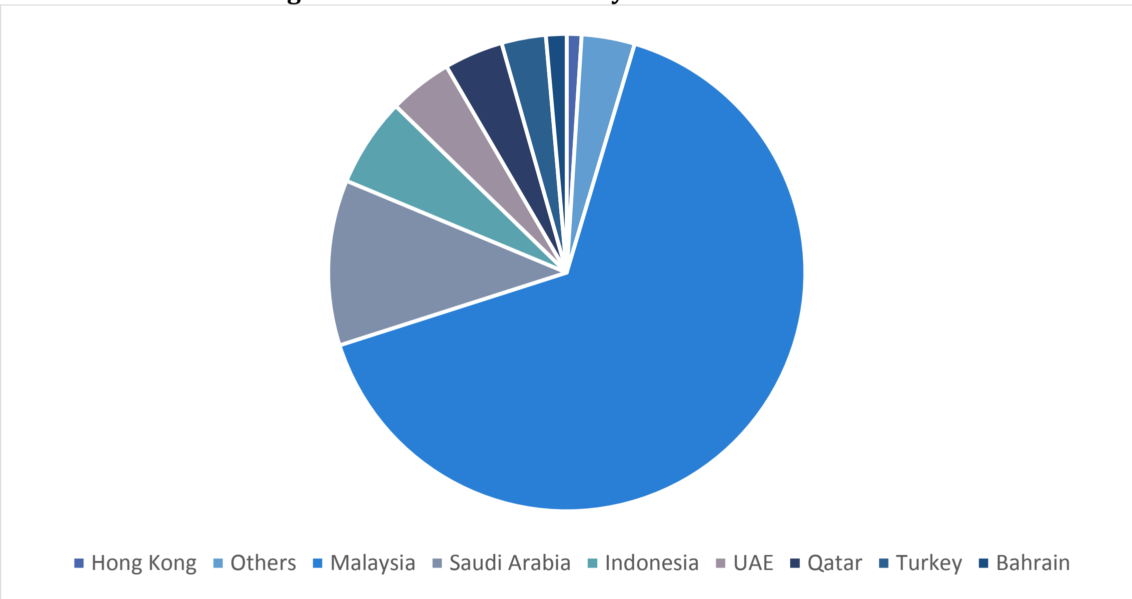
- There are several new markets that have been launched in the sukuk sector.
- In 2014, new sukuk issuances entered into the global primary Sukuk market, which included:
    - the United Kingdom GBP 200 million sukuk issuance
    - Luxembourg EU 200 million sukuk issuance
    - Emirate of Sharjah USD 750 million sukuk issuance
    - Senegal XOF 100 billion sukuk issuance
    - Hong Kong USD 1 billion sukuk issuance
    - South Africa USD 500 million sukuk issuance

- There are debut issuances that are in development. These include:
    - Jordan
    - Mauritania
    - Morocco
    - Oman
    - Tunisia
- Kenya, Kyrgyzstan, and Malta have also considered establishing Islamic capital markets that would include a sukuk market.

Potential of Sukuk

- Several countries that are looking to build a presence in Islamic finance are issuing sovereign sukuk in order to signal to the market that the country is interested in participating in the global Islamic Financial sector.
- There is an increase in demand for sukuk to be used for liquidity management. This has potential to expand further from new issuances throughout Europe, Asia, and Africa.

Figure 1.6: Sukuk Issuance by Domicile and Share



Source: 2015 IFSB Financial Services Industry Stability Report   Note: Domicile is the location of the obligor

1.3.5 Islamic Funds

"Islamic" funds or "Shariah" funds (hereinafter referred to Islamic funds) are fund vehicles which follow the religious laws (hereinafter referred to as "Shariah") laid down by the Holy Qu'ran. For believers, they may therefore be considered as funds with a "religious" connotation, whereby for non-Muslim investors, they frequently fall under the category of ethical or socially responsible funds. Islamic funds can follow Shariah to various degrees, depending on the desires of the fund promoters and managers as well as the expectations of the target investor base. Such degrees may vary from strict adherence to the letter and the spirit of Shariah ("Shariah compliant funds") to a more simplistic approach of funds whose investment strategy is to follow an Islamic index ("Shariah friendly funds").

Key Trends

- Islamic funds have remained a niche segment of the global Islamic finance industry. There was modest growth since the Global Financial Crisis, with Shariah compliant AUM having a CAGR of 6.6 percent between 2009 and 2013.

- Since the third quarter of 2014, the Islamic fund sector experienced a growth of 2.6 percent, with AUM being approximately USD75.8 billion.

- The majority of Islamic fund assets are in Saudi Arabia and Malaysia, with Saudi Arabia having 40% of Islamic Fund Assets by Domicile, and Malaysia having 25%.

Recent Developments

- Due to regulatory reforms and intense competition, Islamic fund managers have been required to amend their fund management strategies.

- The money market has become the prominent class of Islamic funds, comprising 33 percent of Islamic Fund Assets by Asset Class.

Potential of Islamic Funds

- Attracting investors with high net-worth from the Asia-Pacific region would provide a lucrative opportunity for the Islamic funds and asset management sector.

- A market with high potential is investors that are looking to invest in socially responsible funds.

- Further development of Islamic capital market instruments are needed in order to expand the potential sources of Islamic funds.

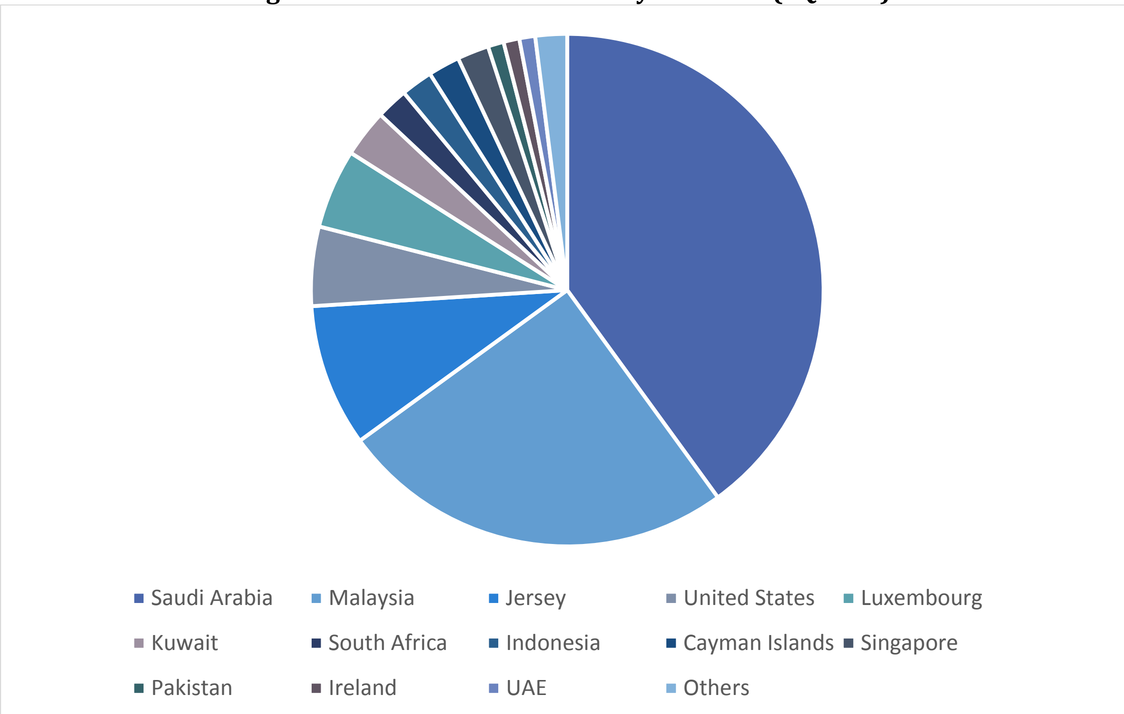
Box 8: Islamic Mutual Funds

The wider acceptance of equity investments by Shariah scholars in the early 1990s paved the way to launch mutual funds that operate in compliance with the ethical guidelines of the Islamic Law (hereafter in this paper to be called Islamic mutual funds). In the early 1990s, many Shariah - compliant mutual funds started to appear. There are now about 126 funds with approximately USD $4 billion in assets under management. Other than being a halal (approved) investment alternative available for Muslim investors, the funds also respond to the specific need for more liquid investment tools.

Further, the launch of reliable equity benchmarks by Dow Jones Islamic Market Index (DJMI) and FTSE Global Islamic Index Series, followed by the Malaysian Kuala Lumpur Syariah Index, has been a turning point for the industry, giving both Islamic and conventional investors something to which to compare. The Dow Jones Islamic Market Index, for example, started with 600 companies in 30 countries, down from 3000 before the religious screening process. One finds reputable companies included in the index including Microsoft, Intel, Kimberly-Clark, Gillette, and Hewlett-Packard (Hassan, 2002). The Dow Jones has now more than 50 Islamic indices those track industries which are compliant with Islamic laws (Hussein and Omran, 2005). Despite the escalating interest in Islamic mutual funds, there has not yet been, to the authors' knowledge, any research concerning the performance of these funds and how they fare in comparison with conventional funds. This study aims at assessing the performance of the Islamic mutual funds, examining whether there exists any significant reward or penalty for investing in them.

Source: 'Islamic mutual funds,' as Chapter 16 in M.K. Hassan and Mervyn Lewis (editors), Handbook of Islamic Banking

Figure1.7: Islamic Fund Assets by Domicile (3Q2014)



Source: 2015 IFSB Financial Services Industry Stability Report

1.3.6 Islamic Derivatives

Derivatives are contracts between two parties with the underlying value of the contract based on an asset or reference parameter, such as a stock, commodity, indices, or currency. Derivatives have been used for hedging, speculation, and arbitrage. Shariah law is adverse to speculative behavior, but Islamic banks do need to utilize derivatives for hedging capabilities. This should be approached with caution, as to not engage in business conduct that is not Shariah compliant.

Islamic derivative instruments that are commonly used in Islamic Finance are:

- **Wa'ad:** This is a contract by a party to enter into a transaction in the future with another elected party.

- **Arbun:** Also known as "earnest money", which is a non-refundable down payment paid for a future sales transaction that is used as an incentive to a prospective buyer to enter into this future sales contract. Notwithstanding, the arbun-buyer is not obligated to enter into the contract. The maximum loss is the buyer losing his/her down payment if the prospective buyers does not enter into the contract. In the case of the sales contract being concluded, the down-payment will be deducted from the purchase price.

- **Salam:** A type of sales contract where a specified good with a specified quantity is sold for delivery at a defined future date. The full purchase price is due in advance.

Key Trends

- Most of the Islamic derivative structures use commodity murabaha as a foundation for facilitating the required cash flows. This has been an issue, since its practice is similar to monetization or tawarruq, which is not always considered Shariah compliant.

- Due to the trading of debt being prohibited by Shariah law, the majority of Shariah Scholars have concluded that derivatives should not be traded. Due to more liberal interpretations of Shariah law, Shariah compliant oil futures contracts have been considered permissible since 2003. This is not the case in the Middle East, where Shariah law is interpreted in a more conservative manner.

Recent Developments

- There has been standard documentation created in order to facilitate the use of Islamic derivatives. Most contracts have been created by the International Islamic Financial Market (IIFM) and International Swaps and Derivatives Association (ISDA).

- In 2015, ISDA launched a new industry data project aimed at developing an open-source standard derivatives product identification system that can be applied consistently and comprehensively across all derivatives facilities, including trading venues, clearing houses, repositories, and other infrastructures.

- In 2015, ISDA announced the launch of a licensing program for ISDA's proprietary and patent pending Standard Initial Margin Model (SIMM) for non-cleared derivatives, offered commercially under the name ISDA SIMM™. ISDA SIMM™ is set to establish a single model that meets regulatory standards, which all authorized licensees can use to exchange collateral in a manner that is consistent with margin requirement rules. By using a single framework to calculate initial margin, licensed counterparties can reduce the potential for disputes. A common methodology also permits timely and transparent dispute resolution and allows consistent regulatory governance and oversight. *Source: isda.org*

1.3.7 Islamic Microfinance

Islamic microfinance represents the confluence of two rapidly growing industries: microfinance and Islamic finance. It has the potential to not only respond to unmet demand but also to combine the Islamic social principle of caring for the less fortunate with microfinance's power to provide financial access to the poor. Unlocking this potential could be the key to providing financial access to millions of Muslim poor who currently reject microfinance products that do not comply with Islamic law. Islamic microfinance is still in its infancy, and business models are just emerging.

Key Trends

- The development of Islamic Savings and Loan cooperatives or BMTs in Indonesia has been impressive. According to the latest estimates there were more than 3,000 BMTs all over Indonesia with consolidated assets of more than USD 100 million, employing more than 30,000 workers, more than 40 percent of whom are women. BMTs served 2 million depositors and distributed micro credit to more than 1.5 million micro entrepreneurs.

Recent Developments

- In 2007, Permodalan BMT ventura, a private finance company founded by Dompet Dhuafa Republika, BMT center was established in order to help BMTs meet their liquidity needs.

- In 2009, The Islamic Micro Finance network (IMFN) was established in Pakistan as a not-for-profit organization. It was formed by a group of Islamic microfinance institutions, dedicated for the development and promotion of the Islamic microfinance industry through innovation, Shariah-compliant product development, institutional capacity building, donor linkages, and up-scaling the Islamic Microfinance Institutions.

- In 2010, Sahulat Microfinance society was established in India as an advocacy organization seeking to popularize the concept of Islamic microfinance.

Potential of Islamic Microfinance

- Islamic Microfinance has the potential to build economic development and tackle poverty alleviation.

- Finding means to minimize costs in order to provide affordable loans to the poor is crucial for the financial sustainability of Islamic microfinance institutions. This can be solved through adopting new technologies that will provide cost efficiency.

- Transforming microfinance to "inclusive finance" has been the subject of much discussion. This shift would provide a diverse assortment of financial services to the impoverished, such as capacity, insurance, and credit facilities. This would allow the poor additional means of acquiring the capital they need through engaging in entrepreneurship, managing their risk, building their income, increasing their savings, and empowering them with the tools needed to socially mobilize themselves out of poverty.

1.3.8 Zakat

Zakat literally means "to be clean, to grow, to increase." It comes from the root letters za, kaf, ya, which has several meanings: to be clean [Al-Quran Chapter 24: Verse 21, Chapter 23: Verse 4], to pay the obligatory charity [Al-Quran 2:43], to be pure, innocent [Al-Quran 19:19, 18:74], to be better in purity [Al-Quran 18:81, 19:13], and to praise oneself, to justify [Al-Quran 53:32]. It has been used in the Quran to mean all of these things. It can also be considered a form of sadaqah (charity), given to the poor. Zakat is also known as zakah.

Zakat is:

- Levied on specific assets only, identified by Shariah (Islamic Law) as assets having the potential for growth.

- Levied at the rate of 2.5% each year (calculated according to the lunar calendar*) on the market value of the Zakat-able assets after deducting therefrom specified liabilities.

- The compulsory transfer of ownership of a portion of the property of the giver, calculated at the rate of 2.5% as aforesaid, to a poor and needy Muslim who qualifies to receive Zakat according to the Shariah.

- An Ibada'h (worship) and not a tax, Obligatory on every Muslim who owns Nisab viz. 613.35 grams of silver, or 87.49 grams of gold or who owns one or more assets liable to Zakat as set out below, equal in value to 613.35 grams of silver or 87.49 grams of gold. . (See Sections 12.1 and 12.2 for more on Nisab).

* Zakat is calculated according to the lunar year. Those who pay Zakat according to the solar year should accordingly, in order to take into account the difference in days, add 3% to the amount of Zakat payable.
Source: Hidaya Foundation

Key Trends

- Actual zakat collected from the Sudan is USD 220 million. The collection has been successful in the Sudan, but additional efforts are needed in order to grow zakat funds collected. In most Sub-Saharan countries, zakat is normally collected in-kind, which is in crops and livestock. Because of this, holding the funds of zakat or zakat fund investment is not an issue. This is also relevant to South and South East Asian countries.

- There are huge collection costs associated with in-kind zakat collection. Also, transporting in-kind zakat collections is costly. On-the-spot distribution of in-kind zakat is a potential solution to this problem.

- Both Indonesia and Malaysia are having steady growth in zakat mobilization, even though zakat collection is required in Malaysia and not in Indonesia. There has also been steady growth in Sudan, with a 19 percent average annual growth rate.

- A policy of decentralization has shown to be successful. An existence of healthy institutions in various levels (both public and private institutions) has shown an impact on the increase of public awareness and public participation in alleviating poverty through the use of zakat.

Recent Developments

- The IFSB in the Ten Year Mid-term Review in 2015 has suggested that the traditional charitable institutions of waqf and Zakat should be integrated into the operations of Islamic microfinance institutions.

Potential of Zakat

- In order to grow zakat collection, incentives for zakat compliance are necessary, such as tax incentives for paying zakat on salaries. There should also be penalties for not paying zakat, such as preconditions on other commercial transactions.

- Means of ensuring transparency and accountability in government regulation and zakat administration are needed in order to improve zakat management.

- Data collections are also needed in order to further measure the status and past history of zakat. This will also create greater transparency of zakat collection and utilization.

Box 9: The Macroeconomic Implications of Zakat

Zakat is collected from all well-to-do Muslims in an Islamic state, and redistributed totally for the purpose of improving social welfare among the needy. Zakat is not a tax on current income, but it is a tax on wealth. Zakat puts an automatic check on the accumulation of hoarded capital or idle wealth in cash form and favors investment into real capital. Zakat has a strong multiplier effect on employment, output, profit and price stabilization through increased investment.

The multiplier effect of zakat is so strong that investment will be undertaken even when the expected rate of profit is zero. Zakat improves the general level of employment through its multiplier effect on investment. Higher capital expenditure in real investments brings about higher value added and thereby higher profits. The derived demand for labor would therefore increase as a result of the improved levels of capital expenditure and output. Zakat also reduces structural unemployment, which mainly arises in the deprived sector of the economy characterized by low human capital, poverty, age and debility.

Structural forms of unemployment are not easily amenable for improvement by increasing the aggregate demand for goods and services. However, in the Islamic economic order the zakat expenditure is put aside and ear-marked for alleviating precisely the structural problems of the society, of which structural form of unemployment is a major issue. The functional role of zakat on structural unemployment suggests that national income accounting comprises expenditures in consumption and investment, and government expenditure, subdivided into zakat expenditure and other autonomous government expenditure. This division of national income accounting implies that the alleviation of structural form of unemployment will be non-inflationary.

Source: Chowdhury, Masudul Alam, M.K. Hassan and Md. Sharif Hussain, 'Zakat in an Islamic Macro-Economic Model,' Chapter 4 in Zakat and Poverty Alleviation, Islamic Economics Research Bureau

1.3.9 Waqf

Waqf in Arabic means to stop, contain, or preserve. In Islamic terms, waqf refers to a religious endowment i.e. a voluntary and irrevocable dedication of one's wealth or portion of it, in cash or kind (such as a house or garden), and its disbursement for Shariah compliant projects, such as mosques or religious schools.

The difference between waqf and charity is that waqf is a permanent donation. Once a waqf is created, it can never be donated as a gift, inherited, or sold. Disbursement of the returns on the waqf is administered in accordance with the endower's wishes. Charity, on the other hand, is a broader concept. It encompasses alms, grants, inheritances, loans, waqf, and other forms.

Waqf comes in 3 Forms:

- **Family Waqf:** The endower of the waqf dedicates the fund to his/her immediate family or other friends or relatives. Upon the death of the waqf beneficiaries, the waqf can then be made into a charitable fund at the request of the endower.

- **Charitable Waqf:** This type of endowment is specifically utilized to help the poor, orphans, widows, or any other charitable cause.

- **Joint Waqf:** The joint waqf is a combination of both the family and charitable waqf.

The general goal of waqf is to help the needy, especially in unforeseen circumstances. The funds from waqf help build mosques and social welfare institutions such as, schools medical center, and facilities from people with special needs.

Key Trends

- Islamic economists have cited the potential role of waqf institutions on economic development and poverty alleviation and have advocated the resurgence of waqf institutions.

- Governments, financial institutions, and other social sector organizations as well as individuals in several Muslim countries have contributed capital towards redeveloping old waqf properties to make them financially profitable and economically significant.

Recent Developments

- Malaysia has developed a substantial amount of waqf properties, with hotels being the recent trend in waqf property development.

Potential of Waqf

- Waqf preservation is the major issue of concern for the management of waqf.

- There needs to be regulatory reform that will strike a balance between waqf preservation and development.

- Waqf developments should be a required obligation of waqf management. Innovative methods for bringing in new waqf capital should be used in further developing existing Awqaf.

- Innovative methods should also be used in creating partnerships between public and private institutions, such as with sukuk. This will enable differentiation between transfer of rights to lease and ownership rights to private financing for a definite appropriate time period that will produce a fair return on capital investment.

- India has substantial waqf properties that would provide the opportunity to bestow benefits to the community, but regulatory reform will need to done in order to bring efficient utilization to waqf properties that will benefit the community as a whole instead of just specific individuals.

1.3.10 Takaful

Takaful is the Islamic counterpart of conventional insurance, and exists both in life (or "family") and general forms. It is based on concepts of mutual solidarity, and a typical Takaful undertaking will consist of a two-tier structure that is a hybrid of a mutual and a commercial form of company. The distinct feature of takaful is that the participant and the fund operator are clearly segregated and the reward for the operator is conditional upon which model of takaful is used.

There are three takaful models:

- Mudarabah
- Wikala
- Waqf

The core theoretical model is based on a framework that is mutually beneficial and cooperative. Due to remuneration demands from contributors in exchange of fund participation, two models were created for takaful, which are the wakalah and mudarabah.

Key Trends

- The global takaful industry has had strong growth rates recently, with global gross Takaful contributions totaling approximately USD 21.4 billion as of first half of 2014. This represents a yearly growth of over 15 percent.

- From 2008 to 2013, global Takaful contributions experienced a growth rate of 15.8 percent CAGR, which stemmed from growth from the main Takaful regions in the GCC, Middle-East, as well as South-East Asia.

Recent Developments

- The Central Bank of Bahrain has introduced a new regulatory framework for Takaful in order to strengthen standards and attract new business to the Takaful industry. These new regulations provide standards for operations and solvency for Takaful firms. This is expected to increase the ability of Takaful firms to distribute surpluses to Takaful policy holders and provide dividends to shareholders.

- In 2013, Autoriti Monetari Brunei Darussalam, the Central Bank of Brunei, announced that there would be new guidelines implemented for Takaful as well as general insurance agents to build good governance standards as well as standardize the commission rates for select classes of business. This is expected to increase the penetration rate of Takaful products in the financial market.

- Malaysia has implemented the Islamic Financial Services Act 2013, which enforces the separation of licenses from general Takaful and family Takaful businesses, with a grace period of two years for current composite Takaful operators to divide into two separate entities.

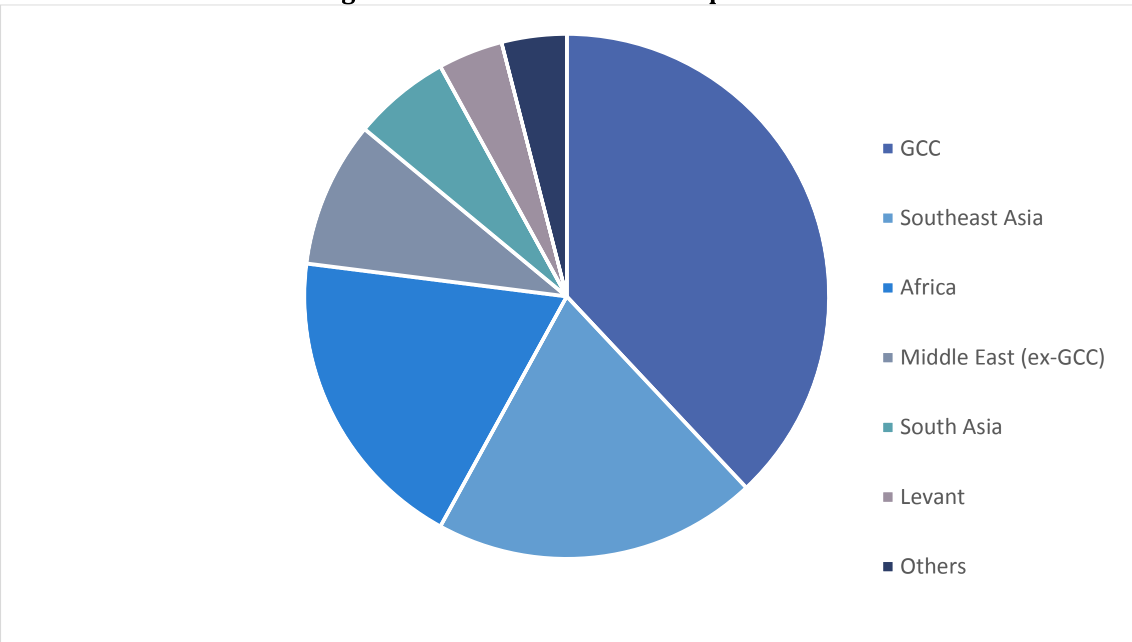
- The Philippines is planning to participate in the global Takaful industry soon, with the Commission of the Philippines creating Takaful regulations in order to provide Takaful services in the country.

Potential of Takaful

- Takaful has the potential for growth in present and new markets.

- Takaful operators are heavily concentrated in GCC countries as well as Southeast Asia, with growth potential in the Middle East, Africa, and Southeast Asia.

Figure 1.8: Number of Takaful Operators



Source: 2015 IFSB Islamic Financial Services Industry Stability Report

1.3.11 ReTakaful

ReTakaful is the Islamic alternative to conventional reinsurance. ReTakaful provides insurance coverage to takaful companies in times of high period claims, such as in fires or natural disasters. A takaful will pay premiums to a ReTakaful company for this type of coverage. The fund operator will be the ReTakaful company. This enables the takaful company to split the risk with the ReTakaful company to prevent the Takaful company from defaulting on its insurance claims.

Key Trends

- ReTakaful companies have grown and the market is fairly concentrated overall.
- Several of ReTakaful companies are actually subsidiaries or are conventional insurance company windows.
- Major re-issuers are starting to enter into the ReTakaful industry sector.

Recent Developments

- Regulators are taking notice of the ReTakaful industry and are developing initiatives to offer transparent markets in the ReTakaful industry, such as Malaysia and Bahrain.
- Other jurisdiction are looking to emulate the model that Malaysia and Bahrain are setting forth.
- Academic journal and industry directories are being established specifically for the Takaful and ReTakaful industry.

Potential of ReTakaful

- Increasing capacity is needed in order for the ReTakaful industry to grow.

- Updating the simple risk-sharing model used in ReTakaful will improve the ReTakaful operations and increase viability

1.4 Global SWOT Analysis of Islamic Finance

1.4.1 Strengths

There has been substantial growth in the Islamic Finance Industry Sector, with general free-market operations. The Islamic Finance Industry adheres to the same standards as the conventional finance industry. There is a generally strong capital adequacy and the industry has shown to be resilient in the past 10 years. There are more than 200 IMFIs (Islamic microfinance institutions) that provide various Islamic products and services. There has been progress in updating regulations on general corporate governance and especially Shariah governance in OIC member countries.

There has also been several online training and career enrichment programs that offer certifications in Islamic finance. Prominent research centers have been created in OIC member countries and elsewhere. Significant progress has happened in developing standards for Islamic finance infrastructure. There has been an increased initiative to adhere to IASB and Basel Committee standards and the majority of Islamic finance jurisdictions completely or partially follow these standards.

There is also an increase in regulation on Islamic financial services that will ensure tax neutrality. Market share for Islamic Finance has expanded, which indicates an increase in the awareness of Islamic financial services. Several collaborative efforts in international Islamic financial infrastructure institutions have been established and continue to be established in order to further grow the industry. Industry Forums have been established in order to foster discussion and innovation as well as collaboration. The Islamic Finance industry also has access to both regional and global markets.

1.4.2 Weaknesses

There are significant variations in transparency in the Islamic financial services sector. There is an inefficient regulatory environment, which hinders the creation of fair competition in the Islamic financial services sector. There are only a few large-scale Islamic finance institutions that are highly capitalized. The IIFS are under-performing in comparison to conventional institutions in regards to capital efficiency.

There has also been past vulnerability in the global financial crisis. There has been a decreasing trend of CAR, capital adequacy ratio, over the past years. Challenges still remain in providing innovative capital instruments that are Shariah-compliant and also adhere to the Basel III/IFSB-15 requirements. There is also a need for an Islamic rating agency that can effectively rate products sold in the Islamic Capital Market.

The impact of the Global Financial Crisis has exposed the many flaws that conventional finance suffers from. This has led to the increase in interest in the Islamic financial system. The Basel and Basel II Accords were created in order to improve the credibility of the global financial system. There are several fundamental differences between the Islamic and conventional financial system that are included on the assets and liabilities sides. Basel II has been utilized as a foundation and reference point for capital adequacy ratio (CAR) guidelines by the AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) and IFSB. The recommendations by AAOFI have biased towards liabilities and the IFSB has recommended focus on assets. Differentiation between financial instruments will allow for appropriate CAR for Islamic Banks. The proper measurement of CAR will allow Islamic financial instruments to adhere to international standards and build credibility of the Islamic financial system on a global scale, which will lead to future industry growth.[2]

There has been growth in the MENA regions in the Small and Medium Enterprises Sector (SME). Despite this, the SME sector is considered to be underfunded, when examining the amount of loans and deposits generated by the banking sector. Hassan and Kayed (2014) find that this results primarily from factors affecting both the demand and supply side. The main reasons for this are lack of focus, absence of an established banking system, and political risk. Regulatory reform and enforcement is also needed to build SME growth, with progress seen in Pakistan.

Box 10: Weaknesses in Islamic Financial Institutions

Global financial crisis revealed many flaws within the conventional financial system and many identified Islamic financial system as a viable alternative. Both Basel I and Basel II Accords were devised with an aim of improving the credibility and soundness of financial system globally. The differences between the conventional and Islamic banks are apparent on both, liabilities and assets side. Although Basel II was never intended for Islamic financial industry, it can be taken as the foundation and improved upon with respect to nature and characteristics of Islamic banking. Both AAOIFI and IFSB tried to develop capital adequacy ratio (CAR) guidelines for Islamic banks taking into account Basel II recommendations as its basis. While AAOIFI's recommendations are biased towards the liabilities side of the balance sheet, the IFSB's recommendations look into assets side as well. There is a dire need for differentiating between the financial instruments in order to come up with an appropriate CAR for Islamic banks. Proper measurement of CAR and meeting the international standards will foster the credibility and soundness of Islamic financial system worldwide. Consequently, this will lead to the future growth of the industry.

Source: "Capital Adequacy Requirements for Islamic Financial Institutions," by Edib Smolo and M. Kabir Hassan

Table 1.5: Regulatory Overview in MENA Countries

Countries	State of Regulations		
	Banking Sector	**Islamic Banking**	**SME**
Egypt	Well-defined	Inception	Non-existent
Pakistan	Well-defined	Well-defined	Well-defined

[2] *Source: "Capital Adequacy Requirements for Islamic Financial Institutions," by Edib Smolo and M. Kabir Hassan*

Countries	State of Regulations		
	Banking Sector	Islamic Banking	SME
Saudi Arabia	Well-defined	Transitional	Transitional
Jordan	Well-defined	Transitional	Non-existent
Morocco	Transitional	Inception	Non-existent
Tunisia	Transitional	Inception	Non-existent
Yemen	Transitional	Transitional	Non-existent
Iraq	Inception	Inception	Non-existent
Lebanon	Well-defined	Inception	Non-existent

Source: Islamic Banking Opportunities across Small and Medium Enterprises in Mena, World Bank Group, p.30

Corporate governance is different for Islamic and conventional banks. These inherent difference stem from the specific types of financial instruments engineered and utilized in Islamic banking. These types of financial products are used in credit transactions and are then served to deposit holders.[3] Because of this structure, specific corporate governance measures are needed to properly monitor these types of investments. These measures should be in terms of stakeholder structure, which consist of profit and loss account holders, current account holders, and credit customers, which should be considered equal to shareholders. There are specific Basel II guidelines for conventional bank corporate governance, but there is no specific guidelines set for Islamic banks.

Box 11: Corporate Governance for Islamic Banks

The corporate governance issue for Islamic banks is much different than it is for commercial banks. Differences are due to the special financial instruments that are engineered for Islamic Banking. These products are utilized in credit transactions and served to the deposit holders. These instruments require us to consider corporate governance for Islamic banks in terms of stakeholder structure. Profit and loss account holders, current account holders and even the credit customers are major stakeholders. It is almost possible to regard them equal to share-holders. Basel II provides guidelines for corporate governance for commercial banks and lacks extensions for Islamic banks.

Source: 'Determinants of Islamic banking profitability' by Hassan, M. Kabir, and A. H. Bashir (2005)

1.4.3 Opportunities

Training programs that cultivate human capital to be able to effectively manage the promotion, operations, and supervision of the industry are needed in order to further grow Islamic finance institutions. There are opportunities to expand Islamic financial services, since only 1% of global microfinance clients utilize these services. There is a need for highly trained Islamic finance professionals in the Takaful market, which indicates job opportunities for Islamic finance professional who are looking to work in the Takaful sector.

[3] *Source: 'Determinants of Islamic banking profitability' by Hassan, M. Kabir, and A. H. Bashir (2005)*

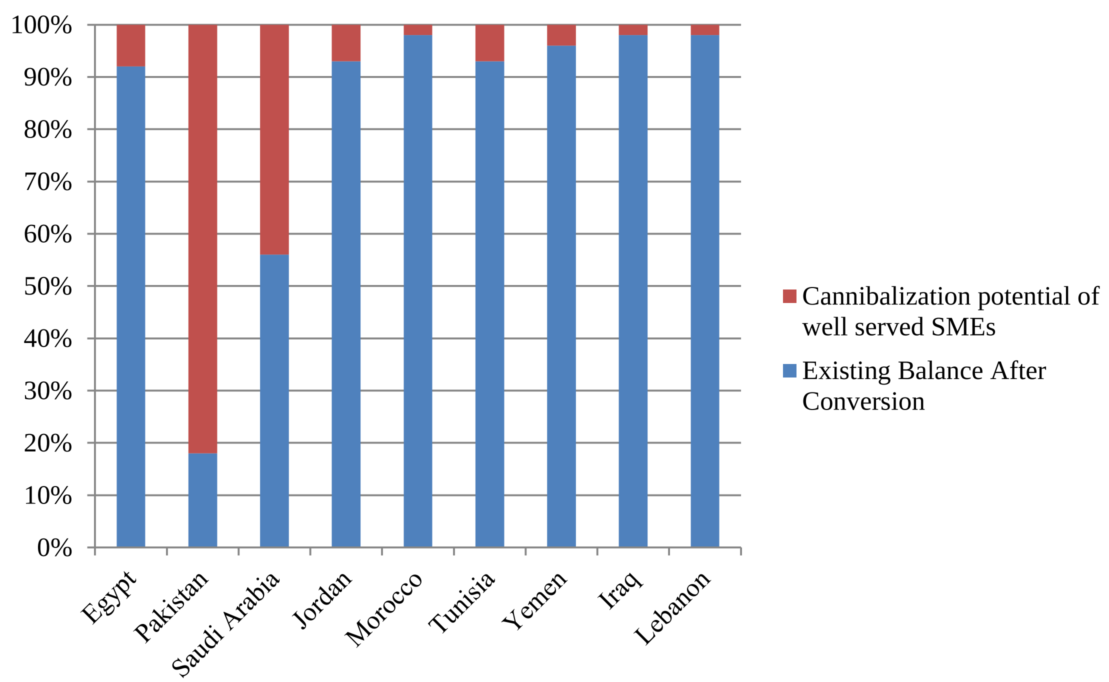
There are tremendous opportunities in regards to financial innovation. Suwailem and Hassan (2014) identify four principles for financial engineering from an Islamic perspective and state the opportunities for financial engineering to develop Shariah-compliant Islamic financial products that satisfy this growing demand from investors. Figure 1.10 shows the substantial opportunities for Islamic conversion throughout MENA countries and Pakistan, with great potential being seen in Egypt, Morocco, Tunisia, Yemen, Iraq, and Lebanon.

Box 12: The Opportunities in Financial Engineering

The world of Islamic finance today is viewed as an important and thriving niche market within the universe of traditional or conventional finance. Financial engineering is as much relevant for Islamic finance as for the mainstream finance as both share a number of characteristics that focus on designing financing modes. It is therefore imperative to shed some light on the nature of Islamic finance in the very beginning. Islamic financial system is a collective notion according to which financial institutions follow a set of comprehensive guidelines commonly known as Islamic Jurisprudence, or simply, Shari'ah, in designing details of their products. As this simple definition puts it, Islamic finance is but organizing financial activities in a manner that complies with a broader set of juristic rules and injunctions governing the entire sphere of human life, of which finance is a part. In this backdrop, it is then easy for one to understand that while engaging in either product development or financial engineering, financial institutions will need to conform to norms of Islamic jurisprudence. A very simple outcome of this binding could mean abandoning financial products that have profits potential but violate one or more such juristic norms.

Source: "An Islamic Perspective of Financial Engineering," by Sami Al-Suwailem and M. Kabir Hassan

Figure 1.9: Islamic Conversion Opportunity Across MENA and Pakistan ($mn)



Source: Entrepreneurship and Islamic Finance, Islamic Banking Opportunities across Small and Medium Enterprises in Mena, World Bank Group, p.43

1.4.4 Threats

Transparency has been a challenge and needs to be a focus of Islamic regulatory agencies. Development of an efficient infrastructure that supports free markets and transparency and adheres to international standards will increase the credibility of Islamic financial products and services. Transparency is also needed in Shariah decisions by Shariah scholars when determining which Islamic financial products are deemed Shariah compliant. Disclosure is needed in order to increase the credibility of Shariah decisions. Outsider Shariah scholars should also be utilized in order to prevent conflicts of interest from insider Shariah scholars when assessing Islamic financial instruments.

Additionally, more innovative Islamic finance products are needed in order to satisfy the demands of the Islamic Finance investor. The argument has been made that Islamic financial products and services are merely replications of conventional financial products services. There needs to be an emphasis on creating new innovative products from original Islamic finance based principles instead of modifying existing conventional products. This will further differentiate Islamic finance from conventional finance.

1.4.5 Conventional vs. Islamic Banks

Table 1.6: Conventional vs. Islamic Banks: A Detailed Comparison

Conventional Banks	Islamic Banks
Governance is based on adhering to government's secular banking laws.	Governance is based on adhering to government's banking laws and Shariah Laws.
Investments are based on profit maximization.	Investments are based on providing funding to ventures that benefit the community. Islamic banks do not invest in ventures that are not Shariah compliant (i.e. gambling, alcohol).
Conventional Banks charge interest on bank loans and depositors receive interest on conventional banking products, such as savings accounts, Individual Retirement Accounts (IRA), Certificate of Deposits (CD).	Islamic banks do not charge interest (riba), which violates Shariah law. Banking is done on a fee based structure and not based on charging passive interest.
Conventional banks commonly trade various forms of derivatives.	Derivatives are considered a form of gharar and are prohibited by Shariah law, due to its association with risky assets, such as sub-prime mortgages and loans.
Conventional banks typically grant loans to entrepreneurs based on a set interest rate.	Loans are granted to entrepreneurs with a profit-loss agreement, where the liability is shared with both the lender and the borrower.
Focus is on building a portfolio of assets, which are loans and minimizing risk through engaging in loan securitization and development of derivatives. This use of placing risk onto other investments provides incentives to grant risky loans and create toxic assets.	Islamic banks focus on investing on assets that are attached to physical assets in order to reduce risk and prevent credit overextension.

1.5 Tasks Needed to Increase Growth Rate of Islamic Banking

- Increase transparency in financial markets
- Develop stronger regulatory systems
- Increase presence of National Shariah Boards in member countries
- Increase talent development in Non-Muslim countries
- Adopt new technologies, such as mobile and online banking, in order to be cost efficient and competitive with conventional banks
- Promote public awareness of Islamic financial services and products in both Muslim and secular countries

1.5.1 Types of New Financial Products that can be developed under Islamic Banking

- New Islamic financial products are needed in order to manage risk.
- Create innovative Islamic financial products that are not based on conventional counterparts.
- Develop cost efficient microfinance contracts that benefit both the microfinance institution and the client, as to not put the client more into debt.

1.5.2 Advantages of Islamic Banking against Conventional Banking in Terms of Financial Stability

Table 1.7: Conventional vs. Islamic Banks: Financial Stability Comparison

Conventional Banks	Islamic Banks
More public awareness of conventional financial products and services.	Shariah standards prohibit Islamic banks from engaging in risky assets and toxic assets.
More access to financial products that mitigate risk, such as derivatives and loan securitization.	Limited access to financial products and services due to more strict disclosure requirements and standards. This increases transparency due to the added disclosure requirements.
Market share is not as concentrated in specific regions as Islamic banks.	Market share is more concentrated in specific regions, but shields itself from risky behavior from profit maximization strategies implemented by conventional banks.

Box 13: The Resiliency of Islamic Finance during the Global Financial Crisis

The conventional view holds that the current global financial crisis was caused by extraordinarily high liquidity, reckless lending practices, and the rapid pace of financial engineering, which created complex and opaque financial instruments used for risk transfer. There was a breakdown of the lender-borrower relationship and informational problems caused by a lack of transparency in asset market prices, particularly in the market for structured credit instruments. There was outdated, lax, or absent regulatory-supervisory oversight; faulty risk management and accounting models; and the emergence of an incentive structure that not only encouraged excessive risk taking but also created a complicit coalition of financial institutions, real estate developers and appraisers, insurance companies, and credit rating agencies whose actions led to a deliberate underpricing of risk.

Such a crisis would not have occurred under an Islamic financial system—due to the fact that most, if not all, of the factors that have caused or contributed to the development and spread of the crisis are not allowed under the rules and guidance of Shariah. The current global financial crisis is largely seen as a real test of the resilience of the Islamic financial services industry and its ability to present itself as a more reliable alternative to the conventional financial system.

Source: M. Kabir Hassan and Rasem N. Kayed, "The Global Financial Crisis and Islamic Finance," Thunderbird International Business Review, Volume 53, Issue 5

1.5.3 Islamic Finance as a Tool for Economic and Social Development in Member Countries

The Islamic Finance industry is becoming a viable alternative to conventional finance. Countries have been adopting Islamic Financial Institutions and the number of Islamic Financial Institutions continues to grow. Regulatory reform has been implemented as well as incentives have been introduced in order to further develop the industry. Islamic financial institutions have also been adopted in Non-Muslim countries, such as the United Kingdom, where British Prime Minister David Cameron made the announcement at the 2013 World Islamic Economic Forum that he wanted London to become "one of the greatest centers of Islamic finance anywhere in the world."

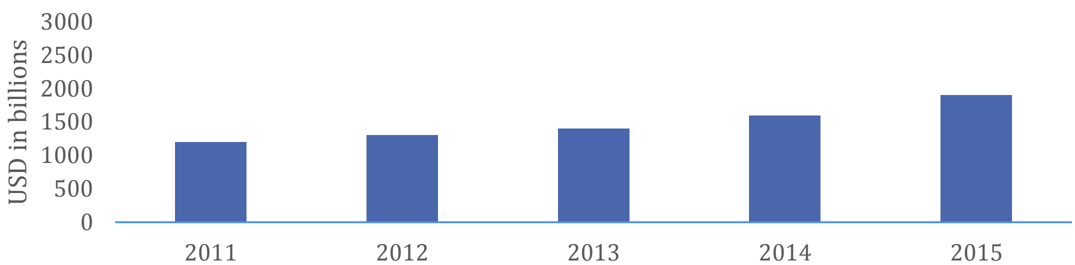
The United Kingdom has five banks dedicated to Islamic finance, more than 20 banks offering Islamic products, and 25 law firms with Islamic finance units. There is USD 38 billion in sukuk, the Islamic equivalent of bonds, listed in London, primarily issued by businesses and banks based in the Middle East. And an issue of £200 million worth of sovereign sukuk in June 2014 was the first such offering outside the Islamic world. Since then, Hong Kong SAR, South Africa, and Luxembourg have issued sovereign sukuk.

Globally, Islamic finance assets grew at double-digit rates in the past decade to reach an estimated USD 1.8 trillion at the end of 2013, with further growth expected (Ernst & Young, 2014; IFSB, 2014; (Wyman, 2009) This growth reflects demand from large and relatively unbanked Muslim populations seeking to deposit money or invest in Shariah-compliant banks and financial products—those that are acceptable under Islamic law (see box). It also represents relatively rapid growth in many countries where these populations reside, as well as the large pool of savings in oil-exporting economies looking for Shariah-compliant investment opportunities. The Islamic Banking and Finance Industry comprises several different entities, including commercial banks, investment banks, takaful companies, and trust funds.

Public awareness has remained a challenge, but has still influenced the expansion of the Islamic Finance industry's market share. Survey respondents have stated that continuous public awareness campaigns that mobilize public interest would contribute to the additional expansion of the industry. The graph from MIFC shows the expansion of Islamic Banking assets by region with substantial growth since 2008 in the MENA and GCC countries, along with growth in Asia.

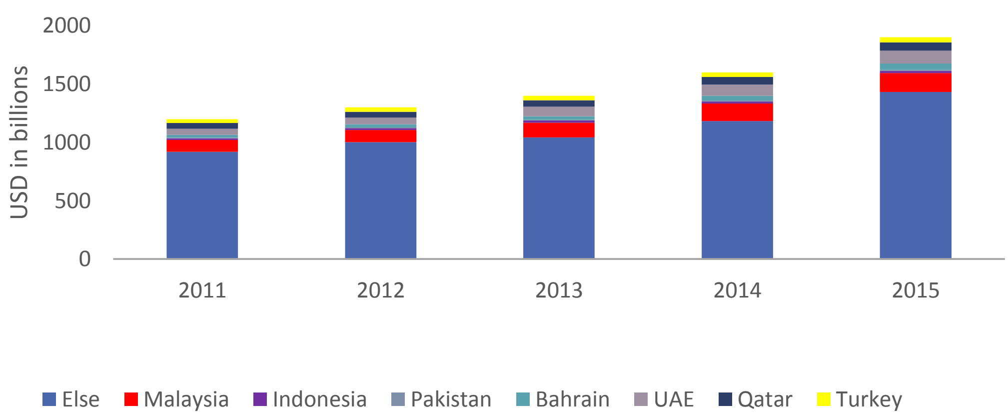
There is a high level of public awareness of Islamic financial services in certain member countries, specifically in GCC countries and Malaysia. These are where the Islamic finance market is well developed. This is not the case in the majority of other countries. The absence of public awareness in these countries, such as Turkey, Indonesia, and Pakistan, inhibits growth in these high-potential markets. The 2012 KFH Research Global Islamic Finance Industry: Stage of Development Map reflects the levels of Islamic Finance development and shows that six major countries have brought the Islamic Finance industry into mainstream relevance.

Figure 1.10: Global Islamic Banking Assets



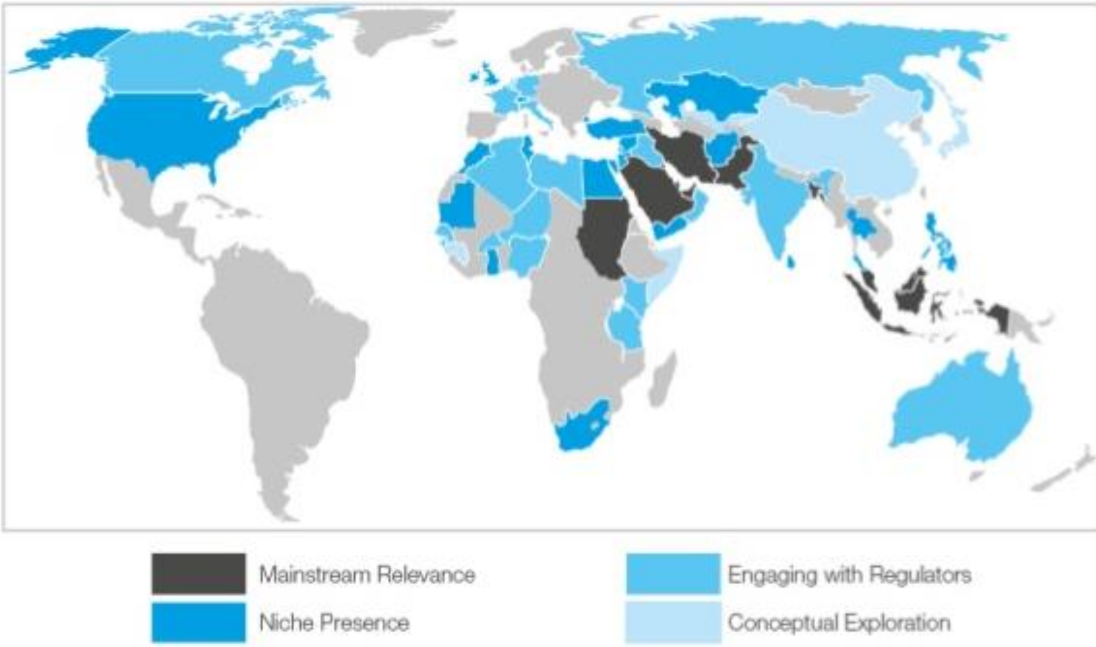
Source: Bankscope Database, 2015; Zawya 2015; IFSB 2015

Figure 1.11: Islamic Banking Assets by Region



Source: Bankscope Database, 2015; Zawya 2015; IFSB 2015

Figure 1.12: Global Islamic Finance Industry Stage of Development



Source: KFH Research (2012)

Chapter 2

2.1 OIC Member Report Survey

In order to further explore the current status and sentiment of the Islamic finance industry, we have developed and administered a survey study 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. Our sample contains a total of 164 respondents from 42 countries, with respondents having multiple field specializations that totaled to 265 responses.

Chapter 2 goes through the different industry segments in Islamic Finance and the findings derived from the survey respondents, which are microfinance, Islamic banking, Islamic capital markets, takaful, and regulation. A roadmap to developing an Islamic Finance Strategy (IFS) is also presented, which provides a reference for a developing a National Islamic Finance Strategy, emphasizing the major components needed in order for the strategy to be effective. The Legal and Conceptual Framework for IFS, Time Scope for IFS, Main Challenges and Obstacles in initial steps and implementation of IFS, Main Components of IFS, Measurement and Evaluation of IFS are included in detail to cover all of the steps needed in order to develop a National Islamic Strategy.

Table 2.1: Field of Specialization Composition for Survey Respondents

Field of Specialization	Number of Responses	% of Total Responses
Islamic Banking	103	63%
Capital Markets	57	35%
Takaful	15	9%
Regulation	33	20%
Islamic Social Finance[4]	57	35%
Total	**265**	

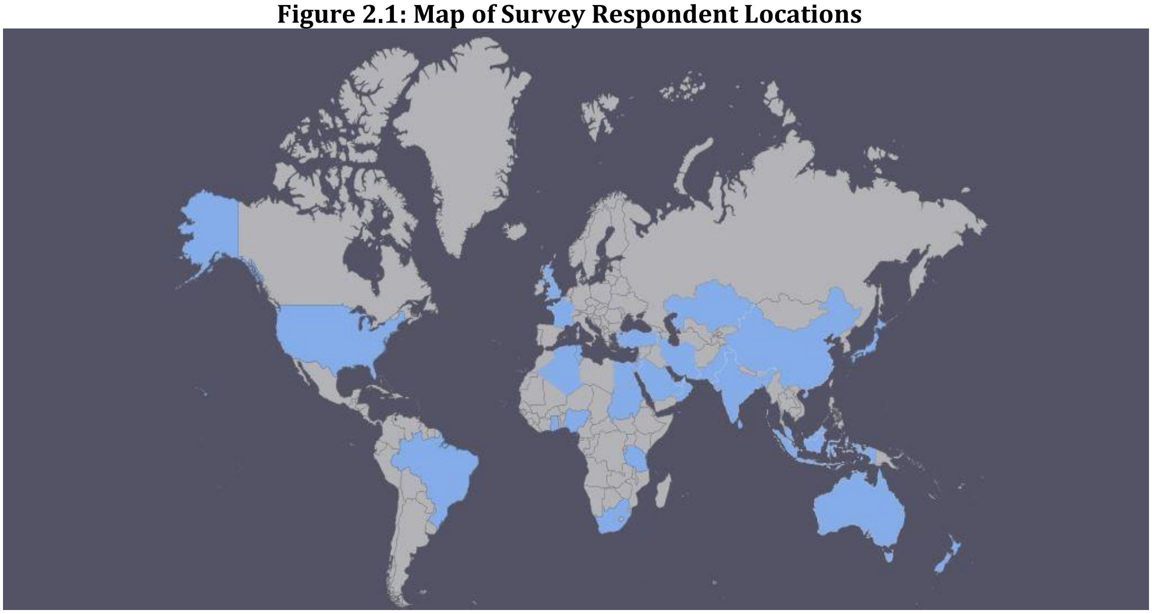
List of survey respondent countries of residence

New Zealand	Tunisia	Brazil	Qatar	Japan	United Arab Emirates	Egypt
Germany	Tanzania	Czech	Australia	Singapore	Bosnia and Herzegovina	Nigeria
France	South Africa	Algeria	Pakistan	Jordon	Saudi Arabia	India

[4] Islamic Social Finance includes microfinance, waqf, and zakat. The main focus of Islamic Social Finance is poverty alleviation and helping the needs of the poor.

United Kingdom	Kuwait	Morocco	Ghana	Kazakhstan	Bahrain	China
Turkey	Bangladesh	Iran	Pakistan	Lebanon	Jordan	Malaysia
United States	Iran	Sudan	Sri Lanka	Oman	Indonesia	

Figure 2.1: Map of Survey Respondent Locations



2.1.1 Microfinance

Effectiveness of Microfinance

84 percent of the respondents state that microfinance attends to the needs of the severely impoverished. More promotion of microfinance to the poor will help expand microfinance. 65 percent of respondents have stated that the higher cost of microfinance drives beneficiaries into severe debt. This indicates that the operations and transactions costs of microfinance need to be reduced in order to better serve the needs of the poor.

Some solutions proposed by respondents are:

- Bayt al-maal wat-tamwilis is utilized in Indonesia and is a form of microfinance institution where sharing and small businesses are the focus to raise the interests of the poor.

  It has two functions:

  1. Baitul tamwil: Bait means home and tamwil means development of assets. Thus, these are homes to develop assets and economic activity.
  2. Decreasing the cost to increase financial inclusion of the poor.

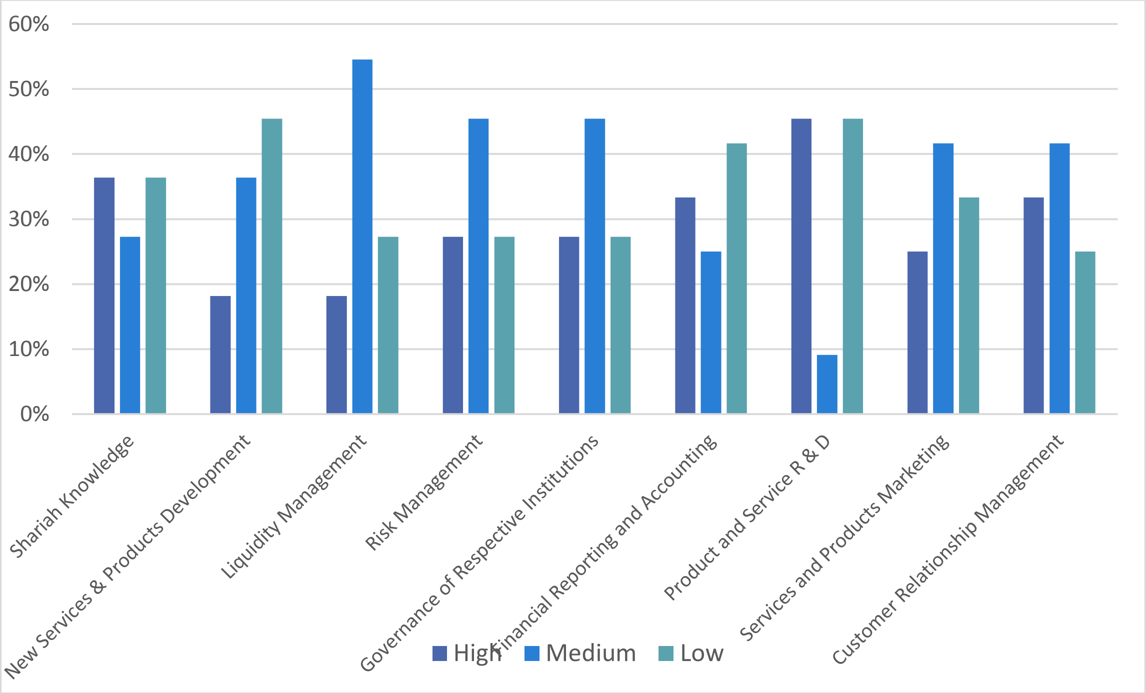
- There should be a more standardized framework for microfinance in order to increase effectiveness in helping the poor.

There is a split between respondents who favor Microfinance institutions being grouped with non-profits and charitable organizations and the other half believing that microfinance institutions should be separate.

Microfinance Infrastructure

Most survey respondents have stated that the way to ensure Shariah compliance in microfinance is through oversight. Increased monitoring of Shariah compliance by Shariah boards will ensure that microfinance business practices adhere to Shariah standards. Good governance is also essential so that operating costs will be formed on the basis of pricing.

Figure 2.2: Respondent's Region's Current Capacity of Islamic Non-banking Financial Institutions and Microfinance Institutions and their staff



Volunteerism

72 percent of respondents consider volunteerism to be an important part of microfinance and further emphasize that microfinance is helpful for the poor. Certain Waqf funds are operated by volunteers and thus have less fixed costs. Promoting volunteerism in microfinance will enable microfinance institutions to reduce operating costs and will also build relationships with the community and the poor to further reduce financial and societal exclusion.

Integrating Microfinance and Charity for isMfis creation

Several solutions from respondents have been proposed, including:

- The establishment of skills empowerment centers that ensure clients are given adequate training prior to being provided financing as well as financial services. This can be facilitated through trade fairs.
- 50 percent of the funding for microfinance can come from a charity or zakah fund.
- Waqfs can be established by isMFis and IFIs where philanthropists can contribute funds for financing the poor in the economy.
- Central banks and regulators can suggest IFIs to designate a proportion of the bank's equity and/or current accounts for which they pay no return to provide qard al hassan and low cost financing to microbusinesses and small farmers.
- Focus should be taken off of commercial objectives and onto philanthropic objectives.
- Incorporating microfinance, zakat, and awqaf together.

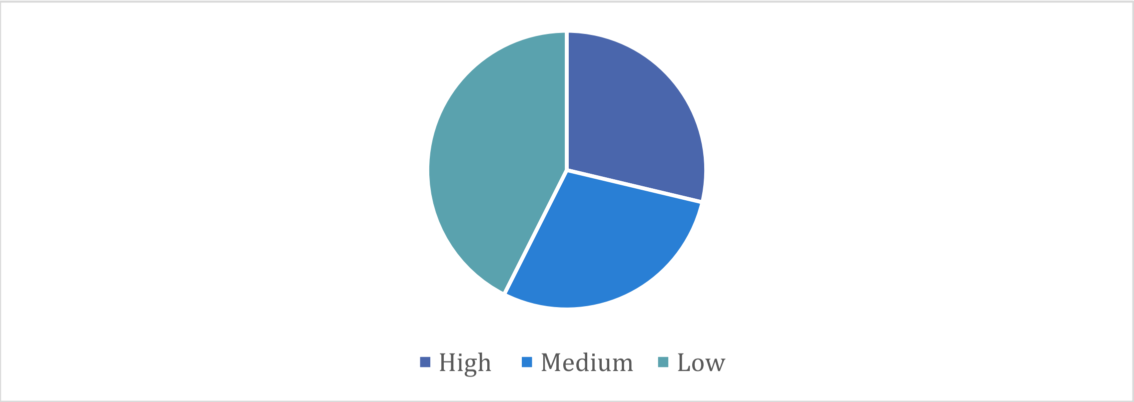
Zakat

100% of respondents believe that zakat should be required and that this is a part of their religious responsibility. Allocation should only be given to the needs of the severely impoverished before anyone else. The best way to ensure that people do not become dependent on zakat is give them a means of employment in order to become financially self-sufficient.

Awqaf

Many of the respondents find that the ideal framework for this type of finance is a national legal framework. Respondents do not support a restriction that can be used on immovable assets, such as real estate. Respondents are split on the effectiveness of the Mutawalli. The laws are not effective in discouraging negligent and dishonest Mutawalli. There should be an updated framework on Mutawalli member selection and governance.

Figure 2.3: Stated Efficiency Level of Mutawallis in Respondents' Regions

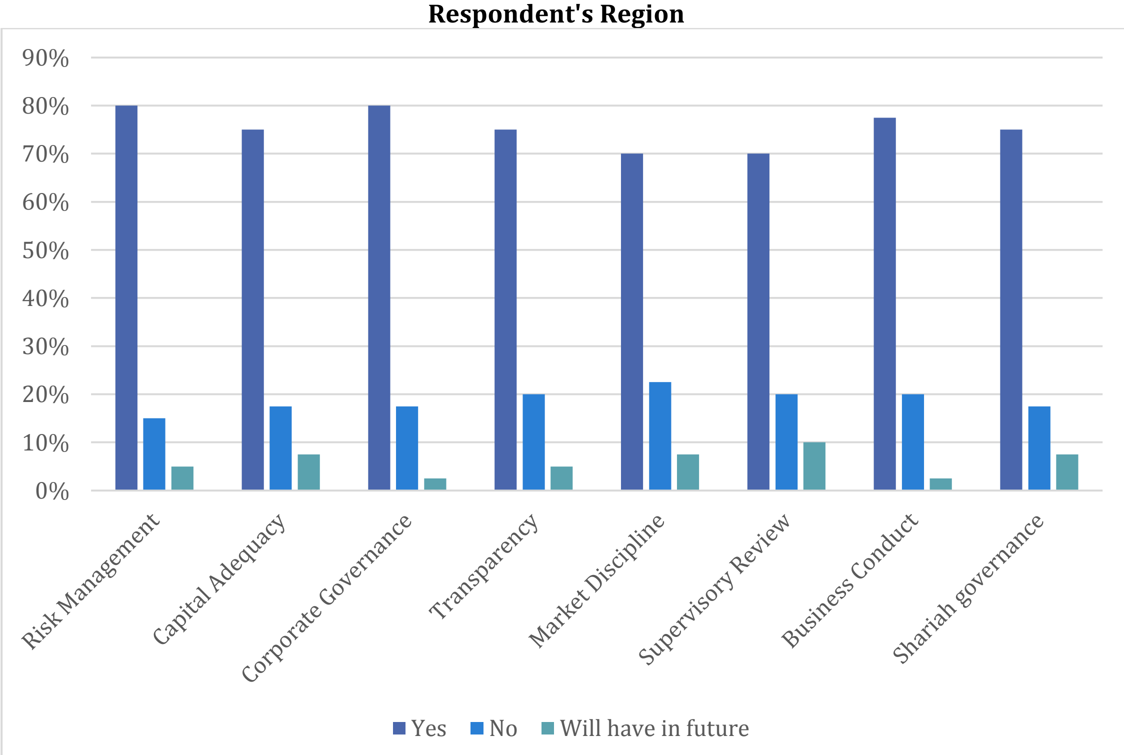


2.1.2 Islamic Banking

Some countries have a dedicated plan that has clear goals that they are trying to achieve, but the majorities do not. Countries that are paving the way for this are Pakistan, Malaysia, and Indonesia. As can be seen in Figure 2.4, several respondents have indicated that infrastructure is already present in their regions.

The survey identifies the need for arbitration and dispute resolution for Islamic transactions. More development needs to be made for monetary and exchange systems. Information and statistical infrastructures need to be developed. Micro-indicators for Islamic banking also are absent. Very few countries have research departments that specifically look at Islamic finance. National Shariah boards or an external Shariah review board need to be developed. Banks and institutions are doing a lot to promote Islamic finance education, but more should be done within the government.

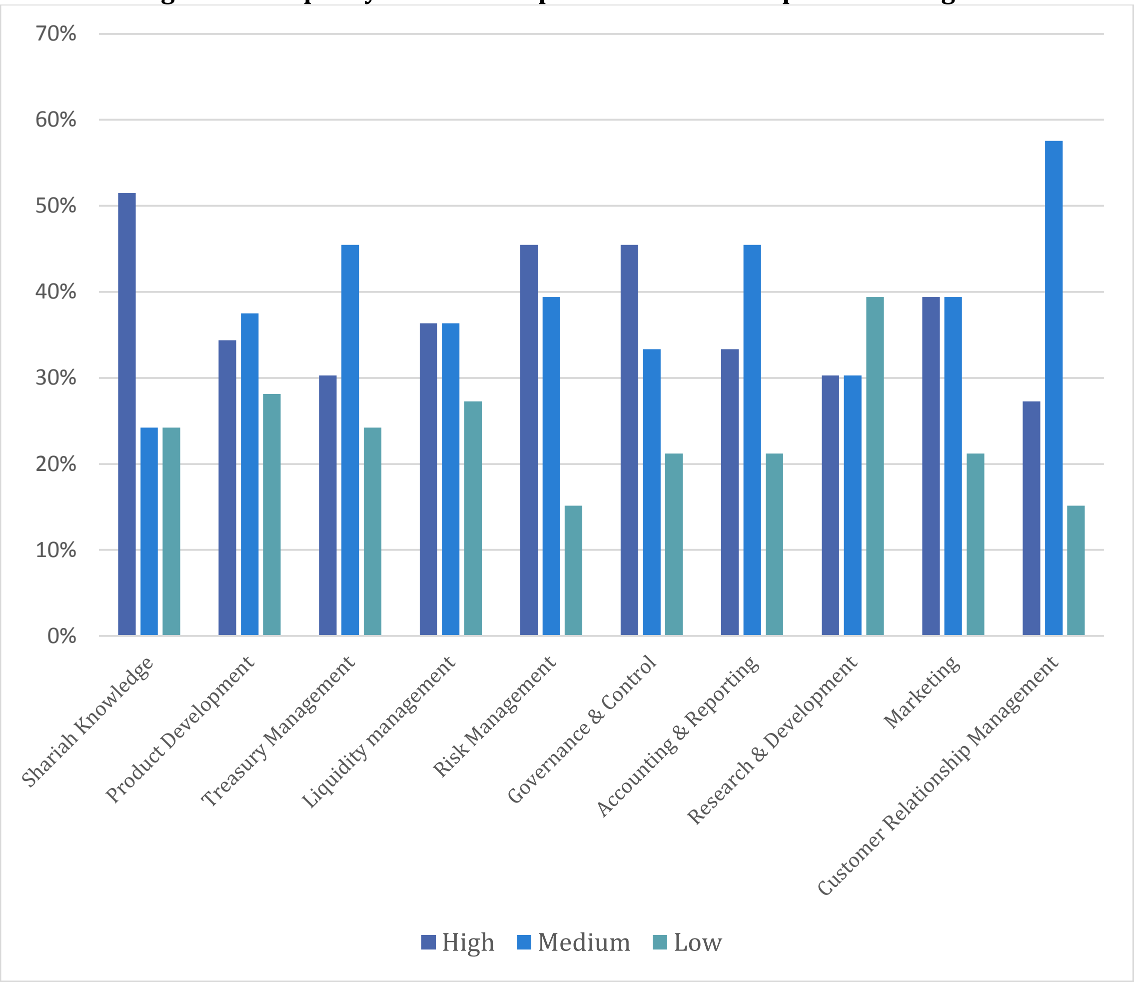
Figure 2.4: Guidelines Present for Infrastructures for Islamic Banking Operations in Respondent's Region



2.1.3 Islamic Capital Markets

Most of the survey respondents consider their region's capacity of ICM is to be between high (37%) to medium (39%), yet there is still a substantial amount that considers their ICM capacity to be low (24%). The same regulations apply to both Islamic and conventional capital markets, yet Islamic capital markets are subject to additional disclosure requirements in order to adhere with Shariah standards. Regulations should be made that are specific to Islamic capital markets that incorporate Shariah standards into the framework. This is currently a challenge, since Islamic finance has not been a priority for regulators in several regions. There is very limited infrastructure for Islamic finance in several regions.

Figure 2.5: Capacity of Islamic Capital Markets in Respondent's Region

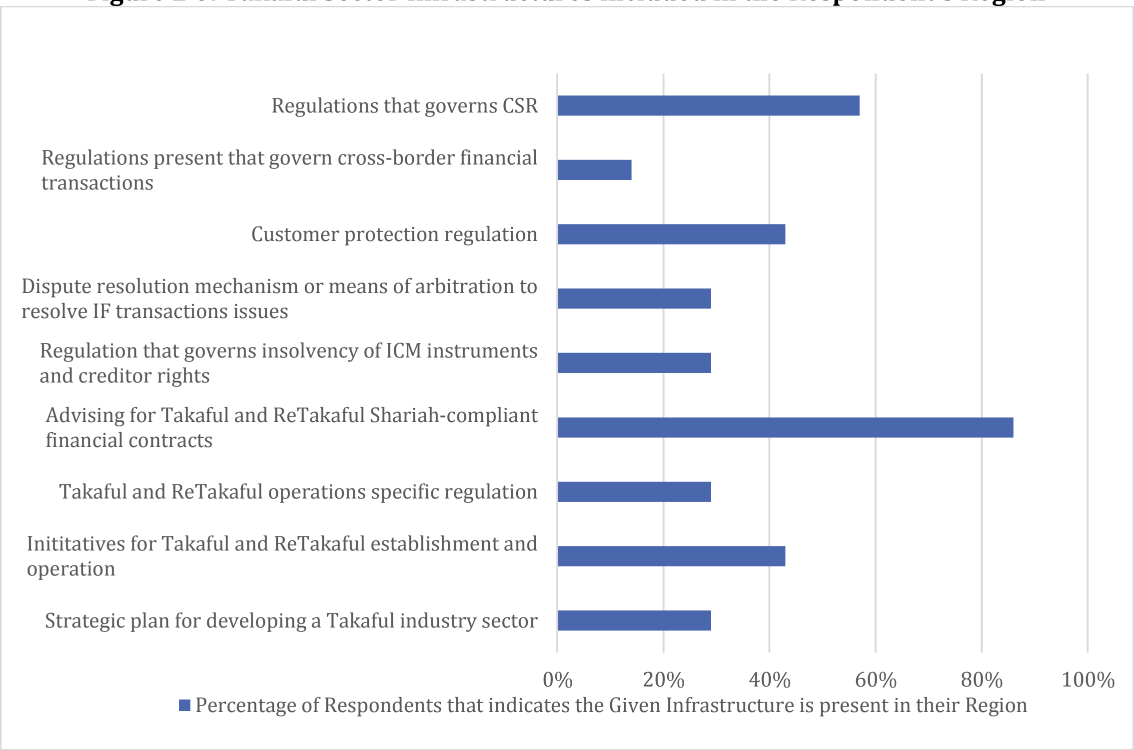


2.1.4 Takaful

There were limited respondents that specialized in the Takaful industry. One main consensus from the respondents is that the infrastructures established for their respective regions are limited. Advising for Takaful and ReTakaful Shariah-compliant financial contracts is established in the majority of the respondent's regions at 86 percent. 43 percent of the respondents confirm that CSR regulation is established in their region. 50 percent of respondents confirmed that there are guidelines specific for Takaful operations and for business conduct, with 33 percent confirming the presence of guidelines for the Takaful solvency requirement. Additionally, 83 percent stated that there are guidelines specific for Takaful operation on Shariah compliance governance. 40 percent confirmed that there standards and guidelines for Takaful and ReTakaful operations in place for both accounting and auditing standards. External Credit Assessment institutions have yet to be established in 71 percent of the respondents' regions.

These results suggest that infrastructure is becoming established in regards to setting standards for ensuring transparency, solvency, Corporate Social Responsibility, and proper business conduct in the Takaful industry in certain OIC regions. Despite this, these initiatives need to be commonplace in more regions and External Credit Assessment institutions need to be established throughout the OIC region in order to provide objective assessment of Takaful products and services.

Figure 2.6: Takaful Sector Infrastructures included in the Respondent's Region



2.1.5 Regulation

Most of the regulation is centered around finance companies and little regulation exists for co-ops and microfinance institutions. There is a substantial amount of regulation for financial institutions. Respondents report similar capital adequacy and regulations to conventional banks. The most common international standards when developing infrastructure is the Basel committee for banking supervision, but IFSB and AAOIFI are also frequently used, but there is a need for national Shariah boards and national Shariah compliance measures in most countries.

2.1.6 OIC Survey Conclusion

The responses have provided added insight into the status of the Islamic finance industry. Some of the responses to certain questions were answered by a smaller proportion of the total sample. This has been taken into account when deriving conclusions from the data. These responses have shown the challenges, opportunities, and potential that Islamic finance has, which has provided information as to what the recommendations should be in growing the Islamic finance industry.

2.2 Roadmap to Develop a National Islamic Finance Strategy (IFS)

The past 5 years have been important in the growth of the Islamic finance industry. Growth has not been without complications. Geopolitical risk is the greatest complication facing the industry. Despite heightened geopolitical complications, the Islamic finance industry continues to grow. Key industries play a large role in the health and development of the Islamic finance industry. Countries of systemic importance hold the majority of Islamic banking assets and tend to drive more of the growth of the Islamic industry. Figure 2.7 shows the countries of systemic importance in Islamic Finance from the IFSB 2015 Islamic Financial Services Industry Stability Report. Countries are considered systemically important when, "the total Islamic banking assets in a country comprise more than 15% of its total domestic banking sector assets or holds at least 5% of the global Islamic banking assets and considers the Islamic banking segment as the criterion for systemic importance of Islamic finance, since about 80% of Islamic financial assets are held within the banking sector" (Islamic Financial Services Board, 2015)

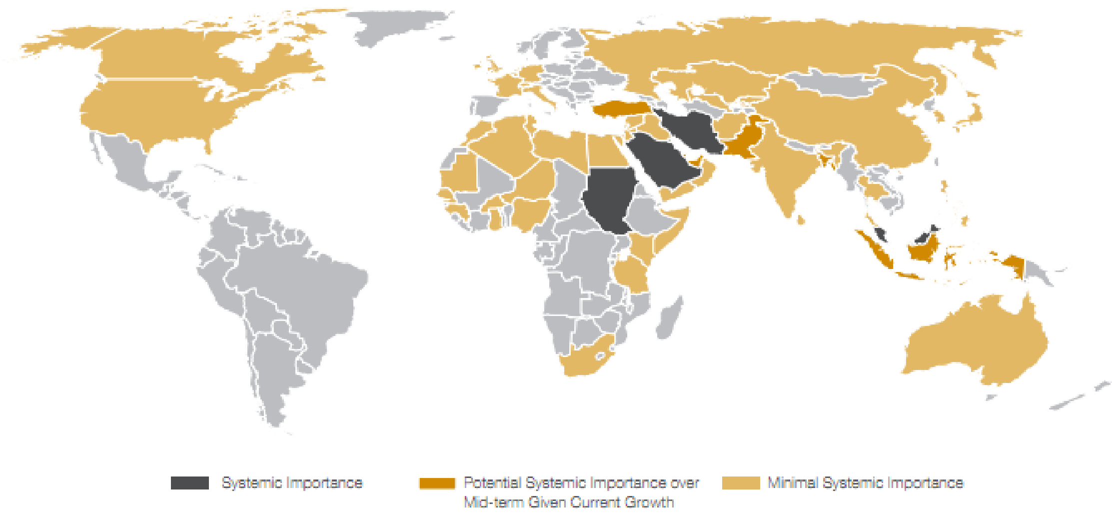
However, growth is not isolated only to countries of systemic importance. Other countries such as Bahrain, Bangladesh, Jordan, Pakistan, and Turkey are also contributing to the growth of the financial sector. Much of the growth in these countries is fueled by the effort of their respective governments to provide regulatory and infrastructure support for the growing Islamic financial services industry. Examples of growth in potential systemic countries can be seen in Turkey where two public banks started their operations after the regulatory approval to establish separate Islamic banking units.

Globally, the Accounting and Auditing Organization for Islamic Financial Institutions is focused on developing new standards to accommodate growth and accountability in the industry. The Islamic Financial Services Board continues to support the industry and its member countries. In 2015, the IFSB launched a new databank of industry indicators. 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:

1. Regulatory
2. Shariah
3. Infrastructure
4. Product and Services
5. Initiatives
6. Talent Development

Figure 2.7: Map of Systemic Importance in Islamic Finance



Source: KFHR, IFSB

Individual countries have made significant infrastructure contributions. In Malaysia, the Islamic Financial Services Act 2013 was introduced. This new legislation is drawing a lot of global attention in the Islamic finance industry. The introduction of the Islamic Financial Services Act 2013 provides greater regulatory clarity. Shariah scholars are now legally accountable for financial products approved. The act distinguishes between deposits made for saving and those made for investment. The implication of this law caused significant adjustment to retail portfolios and is an example of the deep commitment Malaysia has made to the Islamic banking industry.

The Pakistan Central bank has released new details on a new Islamic liquidity framework. The framework would require banks to settle short-term liquidity needs through the IIMM, an Islamic interbank money market, and surplus funds would be absorbed by the central bank. Contributions of individual countries to policy development have spurred more innovations in Islamic finance and several organizations are creating initiatives to further grow research and financial innovation.

2.3 Legal and Conceptual Framework for IFS

55 percent of respondents stated that there is accounting standards put in place for the operations of Islamic banking and 52 percent of respondents stated that there are auditing standards for the operations of Islamic banking. Islamic banking institutions also have followed the standards set by ISRA, Malaysia, King Abdulaziz University Jeddah, IRTI, and IDB. 39 percent of Islamic Capital Market respondents stated that there is a high level of capacity for Accounting and reporting, with 44 percent stating a medium level, and 17 percent stating a low level of capacity. 26 percent of Islamic capital markets also stated that there were accounting standards for ICM products and services in their region. All of the Takaful respondents stated that Shariah standards and guidelines were put in place for Takaful and

ReTakaful operations, while 50 percent stated that accounting and auditing standards were put in place.

In order for free markets to be fair and transparent, regulatory bodies need to update legislation that will require distinct auditing, accounting, and reporting standards. With the Islamic Finance markets expanding on a global scale, it is important to develop partnerships with other countries in order to have more uniform standards to facilitate investment growth on an international scale. Islamic banks are subject to the same disclosure requirements as their conventional counter parts. Additionally, Islamic banks are subject to further disclosure requirements from certain jurisdictions. An example of this is computations of profit and loss. These requirements tend to be more developed in Islamic banking in comparison to the other areas of the Islamic financial services industry. Other areas need to follow suit and further methods of transparency.

Strides have been made by governments, such as in Malaysia and Bahrain, where the promotion of the development of transparent markets has occurred for both Takaful and ReTakaful markets. Despite this, recent studies on the level of transparency in the Takaful and ReTakaful sector has found that it is less than the sectors' conventional counterparts. Also, the 2014 World Bank Governance Indicators show that progress has increased specifically in ease of doing business. There have been improvements in the extent of disclosure in regards to the level of transparency. The World Bank Governance metrics are shown on the next page.

There has been progress in the creation of supervisory frameworks and the development of legislation for Takaful and ReTakaful products in order to ensure tax neutrality. 20 percent of respondents state that there is tax neutrality present in Al Rahnu in their region, 27 percent for microfinance institutions, 20 percent for Islamic Finance companies, and 7 percent of cooperatives.

The World Bank Governance Metrics (seen in Table 2.2) provides a metric in which to assess the effectiveness of a national government. This measurement takes into account 6 major dimensions, which are Voice and Accountability (VA), Political Stability and Absence of Violence/Terrorism (PV), Government Effectiveness (GE), Regulatory Quality (RQ), Rule of Law (RL), and Control of Corruption (CC). Additional information on the details of these metrics can be found at http://info.worldbank.org/governance/wgi/index.aspx#faq.

Table 2.2: World Bank Governance Metrics

	Strength of legal rights index (0=weak to 12=strong)			Ease of doing business index (1=most business-friendly regulations)			CPIA transparency, accountability, and corruption in the public sector rating (1=low to 6=high)			Business extent of disclosure index (0=less disclosure to 10=more disclosure)			CPIA business regulatory environment rating (1=low to 6=high)		
Country Name	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015	2013	2014	2015
Bahrain	1	1	1	..	61	65	..	..	..	8	8	8	..	..	..
Bangladesh	6	6	6	..	172	174	2.5	2.5	..	6	6	6	3.5	3.5	..
Egypt	2	2	2	..	126	131	..	..	..	5	8	8	..	..	..
Indonesia	4	4	5	..	120	109	..	..	..	10	10	10	..	..	..
Iran	2	2	2	..	119	118	..	..	..	7	7	7	..	..	..
Kuwait	2	2	2	..	100	101	..	..	..	4	4	4	..	..	..
Malaysia	7	7	7	..	17	18	..	..	..	10	10	10	..	..	..
Pakistan	3	3	3	..	136	138	2.5	2.5	..	6	6	6	3	3	..
Qatar	1	1	1	..	65	68	..	..	..	5	5	5	..	..	..
Saudi Arabia	2	2	2	..	84	82	..	..	..	8	8	8	..	..	..
Sudan	3	3	3	..	158	159	1.5	1.5	..	0	0	0	3	3	..
Turkey	3	3	3	..	51	55	..	..	..	9	9	9	..	..	..
United Arab Emirates	2	2	2	..	32	31	..	..	..	6	10	10	..	..	..
United Kingdom	7	7	7	..	6	6	..	..	..	10	10	10	..	..	..

Source: World Bank (worldbank.org)

Strength of Legal Rights Index 2014 Rating from 0 to 12 (0=weak to 12=strong). Ease of doing business score is assessed with a ranking system from 1 to 189 (1=most business-friendly regulations). The CPIA transparency, accountability, and corruption in the public sector rating is from 1 to 6 (1=low to 6=high). Business Regulatory Environment is a rating from 1 to 6 (6 being a high rating and 1 being a low rating). Business extent of disclosure index is from 0 to 10 and (0=less disclosure to 10=more disclosure). The CPIA business regulatory environment rating is from 1 to 6 (1=low to 6=high).

As can be seen from Table 2.2, the most business-friendly regulations are attributed to the United Kingdom, Malaysia, the United Arab Emirates, followed by Turkey and Bahrain, with the lowest being in Bangladesh, Pakistan, and Sudan. The stronger legal rights can be seen in the United Kingdom, Malaysia, and Bangladesh, with the weaker being in Bahrain, Qatar, Egypt, Iran, Kuwait, the UAE, and Saudi Arabia.

There is very limited ratings for the CPIA transparency, accountability, and corruption in the public sector rating, with just ratings for Bangladesh, Pakistan, and Sudan, which are very low. For the Business extent of disclosure index, there are high ratings for Indonesia, Malaysia, the United Arab Emirates, the United Kingdom, and Turkey. There also high ratings for Bahrain, Egypt, Pakistan, and Iran and lower ratings for Sudan and Kuwait. There is very limited ratings for the CPIA business regulatory environment rating (1=low to 6=high), with just ratings for Bangladesh, Pakistan, and Sudan, which all have lower ratings that are below 4.

These ratings indicate what can be improved upon when developing an OIC Member country's National Islamic Finance Strategy. As can be seen, there are substantial opportunities to develop regulations that can increase ease of doing business, business extent of disclosure, transparency, accountability, and reduce corruption.

2.3.1 Time Scope for IFS

Table 2.3: 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

<table>
<tr><th>Term</th><th>Objective</th><th>Stakeholder</th></tr>
<tr><td rowspan="3"></td><td>• 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.</td><td>• Islamic Financial Institutions
• Islamic Finance Industry Organizations
• Governments
• Central Banks
• Research Institutions
• Islamic Non-financial Institutions</td></tr>
<tr><td>• Increase presence of Shariah Boards in monitoring Shariah compliant business practices
  ○ Increase communication between national and local Shariah boards.</td><td>• Islamic Financial Institutions
• Islamic Finance Industry Organizations
• Governments</td></tr>
<tr><td>• Increase stability of regulatory bodies. Review of existing laws and regulations should create more stability and further define roles.</td><td>• Islamic Financial Institutions
• Governments
• Central Banks</td></tr>
<tr><td rowspan="3">Medium-term</td><td>• 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.</td><td>• Islamic Financial Institutions
• Governments
• Central Banks</td></tr>
<tr><td>• Increase awareness and education of Islamic Finance
  ○ Launch national campaigns to increase the awareness or Islamic finance.</td><td>• Islamic Finance Industry Organizations</td></tr>
<tr><td>• Create additional Islamic Capital Markets Indices</td><td>• Governments
• Central Banks</td></tr>
</table>

Term	Objective	Stakeholder
	• 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
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[5] 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

2.3.2 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.

[5] Secular countries are countries that are not subject or bound to religious rule.

This can be done through efficient and clear regulation that ensures that Islamic microfinance business practices are. 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.

- **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. 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.

  OIC Member countries should include participating in non-Muslim markets in their national Islamic Finance strategy. The demand Islamic financial products in these markets are 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.

- **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. 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.

- **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.

- **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. 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.

  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, which are Al-Huda CIBE, Iqra University, Institute of Business Management (IOBM) (Institute), International Islamic University, and the National University of Science & Technology (NUST). 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[6] Airlangga University, LPPI Indonesian Banking Development Institute (Institute), and Paramadina Graduate School (Institute).

- **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. 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.

2.3.3 Main Components of IFS

1. 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.

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

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. 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.

2. 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.

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.

3. 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.

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

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

5. Initiatives

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

Opportunities:

- Develop Human Capital
- Increase cost efficiency of operations
- Increase data collection
- Increase collaboration
- Strengthen Regulation
- Ensure Tax Neutrality[7]
- Promote research and innovation
- Educate people on Islamic Finance

[7] Tax neutrality refers to having a tax system that aims to be neutral so that decisions are based on economic benefits as opposed to reasons of taxation as well as a tax system that does not influence a taxpayer on determining which investment to undertake on the basis tax laws.

6. Talent Development

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

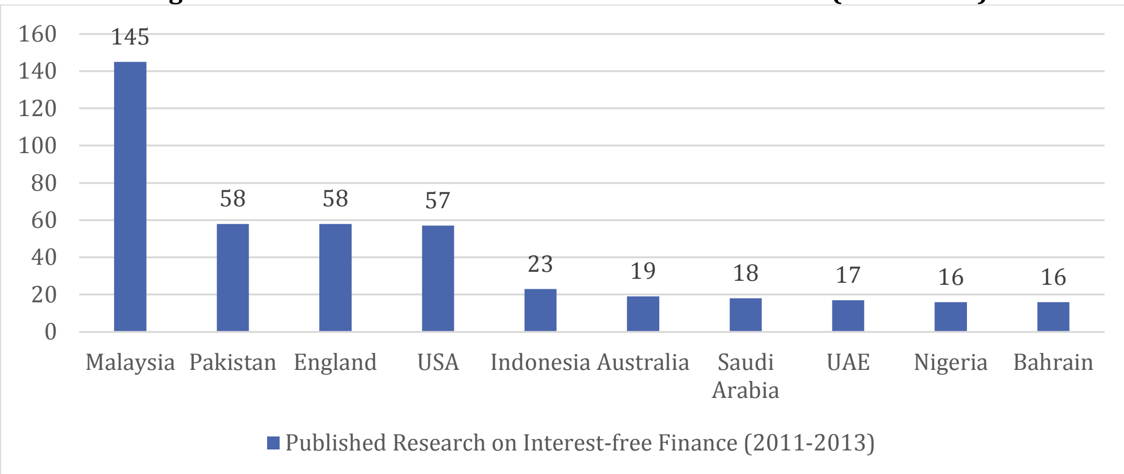
Several institutions are also conducting research on Islamic Finance, including:

- International Shariah Research Academy for Islamic Finance
- Indonesian Banking Development Institute (LPPI)
- Karim Consulting
- Tazkia Consulting
- The Center for Economics and Business (PEBS)
- Ernst & Young, who issues a detailed "World Islamic Competitiveness Report" annually as well as the "World Takaful Report"
- Riphah Center of Islamic Business in Islamabad
- The "World Bank Global Islamic Finance Development Center" hosted by Borsa Istanbul

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.
- Also, additional research has been undertaken on relevant topics from Islamic finance sectors, including:
    - Integration of Zakat and Waqf Equity crowdfunding for Shariah-compliant SMEs microfinance
    - Islamic banking
    - Takaful
    - Islamic Monetary and Islamic Financial Markets
    - Hybrid model of Islamic Microfinance banking where IMFI can work directly with merchants on behalf of their clients.

Figure 2.8: Published Research on Interest-free Finance (2011-2013)



Source: ICD Thomson Reuters Islamic Finance Development Report 2014

2.3.4 Measurement and Evaluation of IFS

Table 2.4: Modalities to Assess Performance of IFS

Modalities to Assess Performance	
Internal Performance	**External Performance**
Evaluation of services provided	Persistent market evaluations
Quarterly report written by Islamic Financial Analysts	Shariah and Islamic Financial rating agencies needed in order to rate Islamic Financial Products and Services and ensure Shariah compliance
Utilize digital banking which will generate internal data which can be used for analysis of service efficiency.	Facilitate and encourage free, fair, and transparent markets
Measure customer sentiments	Enhance capitalization and efficiency of Islamic Financial institutions

There are several challenges that are present regarding the international standards of the Islamic finance sector. 43 percent of the respondents have stated that there are contradictions within the existing rules and regulations. 30 percent have stated that applying the international standards for Takaful operations is not the regulatory and supervisory authorities' (RSA) priority. 61 percent have stated that there is no enforcement present from an international standard setting entity. 48 percent have stated that there is an absence of awareness of international standards. 57 percent have stated that there is inadequate knowledge and understanding of implementing the standards and 52 percent have stated that there is a shortage of supporting infrastructures for implementing the standards.

In regards to Islamic non-banking financial institutions and microfinance, 8 percent of respondents stated that there are contradictions within the existing rules and regulations, 23 percent stated that there is no enforcement present from an international standard setting entity, 30 percent stated that there is inadequate knowledge and understanding of implementing the standards, and 38 percent stated that there is a shortage of supporting infrastructures for implementing the standards.

This reflects the need for consistent international standards governing Islamic Finance as well as enforcement of those standards. Creation of a stable infrastructure and initiatives and organizations that promote the implementation of those standards are also required in order to ensure adherence to international standards for the Islamic Finance industry.

Table 2.5: Islamic Finance Strategy Roadmap

No	IFS Component	Task #	Recommendation	Time Frame								
				'16 Q3	'17 Q1	'17 Q3	'18 Q1	'18 Q3	'19 Q1	'19 Q3	'20 Q1	'20 Q3
1	Regulatory	1.1	Review existing regulations and guidelines to ensure compatibility with Shariah guidelines	X								
		1.2	Develop a regulatory agency to monitor secondary markets and exchanges	X	X	X						
		1.3	Develop a legal infrastructure to foster growth of the Islamic financial system	X	X							
		1.4	Develop specific disclosure guidelines for Islamic banks that increases transparency		X	X						
2	Shariah	2.1	Create an independent National Shariah Board to provide oversight and governance to internal and independent	X	X							

No	IFS Component	Task #	Recommendation	Time Frame								
				'16 Q3	'17 Q1	'17 Q3	'18 Q1	'18 Q3	'19 Q1	'19 Q3	'20 Q1	'20 Q3
			Shariah boards.									
		2.2	Develop seminar and training programs for Shariah scholars about Islamic banking operations and product development			X	X					
		2.3	Increase collaboration between Shariah scholars and Islamic bank management					X				
3	Infrastructure	3.1	Develop secondary markets for Islamic financial products		X	X	X	X				
		3.2	Develop exchanges for Islamic financial products		X	X	X	X				
		3.3	Adopt a national Islamic banking accounting standard	X	X							
		3.4	Revaluate liquidity management frameworks for national banks	X								
		3.5	Develop a specific liquidity framework for Islamic banks	X								

No	IFS Component	Task #	Recommendation	Time Frame								
				'16 Q3	'17 Q1	'17 Q3	'18 Q1	'18 Q3	'19 Q1	'19 Q3	'20 Q1	'20 Q3
4	Products and Services	4.1	Increase range of Islamic products and services to satisfy the needs and demands of the Islamic finance and Islamic social finance client	X	X	X	X	X	X	X	X	X
		4.2	Encourage innovation and adoption of new technology	X	X	X	X	X	X	X	X	X
		4.3	Revaluate tax implementations for Islamic financial services and products	X	X							
5	Initiatives	5.1	Develop national campaigns to increase brand awareness of Islamic finance and social finance	X	X	X	X					
		5.2	Create a new campaign to focus on the positives of Islamic finance for non-Muslim investors	X	X	X	X					
		5.3	Encourage expansion of Islamic social finance in order to promote financial inclusion for the poor.	X	X							

No	IFS Component	Task #	Recommendation	Time Frame								
				'16 Q3	'17 Q1	'17 Q3	'18 Q1	'18 Q3	'19 Q1	'19 Q3	'20 Q1	'20 Q3
	Talent Development	6.1	Promote and sponsor academic research on Islamic finance and social finance	X	X	X	X	X	X	X	X	X
		6.2	Increase training and academic programs specific to Islamic finance	X	X	X						
		6.3	Develop industry certifications for Islamic finance	X	X							
		6.4	Create scholarship and grant programs that sponsor individuals who are interested in working in the Islamic finance industry	X	X							
		6.5	Create Islamic finance industry trade associations	X	X							
		6.6	Develop and host conferences for Islamic finance industry members, researchers, and regulators to share ideas and collaborate on ways of growing and improving the industry	X	X	X	X	X	X	X	X	X

2.4 Examination of Existing National Strategies

Of the countries observed in Chapter 3, only 4 have existing national plans (Pakistan, Qatar, Indonesia, and Turkey[8]). This section will examine, on a country level, the presence, or absence, of an existing national plan. Countries that currently have a national plan can still benefit from the roadmap. This section will highlight some aspects of the IFS roadmap that can be applied for the benefit of the subject country.

Malaysia is a leader in Islamic Finance services, planning, and implementation. Because of Malaysia's dedication to Islamic finance they have been able to foster growth. Malaysia has a solid regulatory and legal framework for Islamic finance. Malaysia current environment could benefit from more product development and initiatives. A strategic plan that focuses on new product development, sustained growth through initiatives, and the human capital development in the Islamic financial services industry could ensure sustained growth for the future.

Pakistan's current Islamic finance strategy focuses on Enabling Policy Environment, Shariah Governance & Compliance, Awareness and Capacity Building, and Market Development. These goals are very similar to a six component plan discussed in earlier sections. Implementation of this plan should yield positive results for the Islamic finance industry in Pakistan. However, proceeding plans should continue to push the envelope and further strengthen Pakistan's weaknesses. More initiatives, a stronger regulatory environment, and more human capital development, a weakness in Pakistan, will allow the country to continue the recent success in developing Islamic finance.

Turkey is poised to have strong growth in the Islamic financial industry. Their strategic plan is a good starting point to ensure continued growth in their country. The existing plan has 4 key components Improving the current perception towards interest-free finance system, Improving human resources in the interest-free finance sector and enriching the literature, Developing the corporate structure and the legal infrastructure of the interest-free finance system, and Increasing the diversity of interest-free financial products and services. These four points has many similarities with the components of our six component plan discussed in previous sections. Their plan is a positive step for Islamic finance domestically and internationally.

The need for an independent national Islamic finance strategy is limited in the UAE. Many Islamic banking initiatives are included in the legal infrastructure of the country. Because of the close connection of the Islamic finance to the country, a national Islamic finance strategy should be included in a national strategy. By including an Islamic finance strategy into a national plan the UAE will be able to better drive growth through the use of initiatives, new product and services, and talent development.

Qatar has a national strategic plan for the growth of Islamic finance. They have several components mentioned in previous sections. Human capital, growing market infrastructure,

[8] National Strategy documents can be found: Pakistan: http://www.sbp.org.pk/departments/pdf/StrategicPlanPDF/Strategy%20Paper-Final.pdf ; Qatar: http://www.gsdp.gov.qa/gsdp_vision/docs/NDS_EN.pdf ; Indonesia: http://www.bi.go.id/en/perbankan/syariah/Documents/Grand_Strategy_of_Islamic_Banking_Market_Developme.pdf ; Malaysia: http://www.bnm.gov.my/index.php?ch=en_speech&pg=en_speech_all&ac=564

and enhancing a legal and regulatory infrastructure are some of the highlights of their strategic plan for future growth. If they achieve the elements of their strategic plan they should see stronger Islamic financial services growth.

There is no National Islamic Finance Strategy set forth in Egypt. There are limited academic institutions that offer training specific to Islamic finance, with only three universities offering training programs in Islamic banking. There is no external Shariah board present in Egypt. There is limited infrastructure for Islamic social finance, which holds great potential for helping the poor in Egypt, with a 25.2% poverty rate in 2011[9].

An external Shariah review board is needed in order to ensure a uniform standard of Shariah compliance of Islamic financial products and services. There is limited access to training and higher education in Islamic finance, with just three academic institutions offering training in Islamic banking. There is also a limited presence of Islamic social finance, which is greatly needed to promote financial inclusion of the impoverished that has increased due to high unemployment and a greatly increasing population with an estimated 25% poverty rate in 2012.[10]

Indonesia has the world's largest Muslim population and is very active in Islamic banking. However, they lack a coherent strategic plan. By creating a strategic plan and following the guidelines recommended by this report, Indonesia can position itself to be one of the fastest growing Islamic banking countries in the world. Because there already exists much of the infrastructure for Islamic banking growth a strategic plan in Indonesia should focus on talent development and new and innovative product and services. By strategically addressing these areas, Indonesia's Islamic banking sector is poised for strong growth.

Initiatives are needed in order to stabilize the region. Islamic social finance will help rebuild war affected areas and help the poor. Additional talent development is needed in order to build capacity for both Islamic finance and social finance. More innovative Islamic financial products and services can add to the range offered by Islamic financial institutions and would also promote financial engineering and innovation.

There is presently no Islamic finance strategy in Kuwait. There is very limited access to training in Islamic finance, with a single academic institution offering such training. Initiatives have been implemented in order to develop a Capital Markets Board. This has been successful in providing additional regulation for capital markets. Despite this, additional initiatives are needed in order to further grow the Islamic finance industry in Kuwait. Additional regulations are needed to govern Islamic banking, as well as Islamic social finance. There also needs to be external Shariah boards that assess Islamic finance products, services, and Islamic financial and non-financial institutions business practices. This can be done through a main external Shariah board that determines standardized Shariah rules in order to build transparency and standardization of IF business practices those are Shariah-compliant.

[9] "POPULATION BELOW POVERTY LINE." *Central Intelligence Agency*. Central Intelligence Agency, n.d. Web. 17 Dec. 2015. <https://www.cia.gov/library/publications/the-world-factbook/fields/2046.html>.

[10] "In Saudi Arabia, Unemployment and Booming Population Drive Growing Poverty." Washington Post. The Washington Post, n.d. Web. 17 Dec.2015.<https://www.washingtonpost.com/world/in-saudi-arabia-unemployment-and-booming-population-drive-growing-poverty/2012/12/02/458e648c-3987-11e2-a263-f0ebffed2f15_story.html>.

Table 2.6: Comparison and Contrast of Existing Financial Plans

Strategic Component	Component as Identified in the strategic plan	Comparison
Regulatory	• "The most important building block for sustainable growth and development of Islamic banking is the enabling legal framework. (Strategic Plan, Pakistan 2014)" The current legal framework is not adequate to provide the support necessary for future industry growth. • Enhance regulation and oversight framework for Islamic banking institutions. This will better prepare	• Regulatory oversight is a key component for any financial structure to grow. The importance of this component is emphasized in the plans of Pakistan and Turkey. • This component should be added to the two existing strategies as well as expanded to cover all countries.
Shariah	• Pakistan lacks the proper Sharia compliance measures for proper growth. A new framework will be developed.	• Sharia governance is a necessary for the proper growth of Islamic finance. • This component is absent from most national strategies, however, scholars agree this is a key component that should not be forgotten.
Infrastructure	• The country lacks proper infrastructure for rapid interest-free finance development. A more proper infrastructure for development will be created. • Strengthen market infrastructure.	• A stable infrastructure is need to develop finance. While many plans have this as a component, this report will give more precise and detailed imitative that will help develop a production infrastructure.
Products and Services	• New products and innovation will increase demand and interest in Pakistan's Islamic banking industry. • Increase the diversity of interest-free financial products and services.	• New products ensure innovation. Similar to infrastructure this report will lay out what new product and services should be developed.
Initiatives	• A new awareness campaign will be launched to increase the public's perception of Islamic finance in Pakistan. • A publicity campaign to promote interest-free-free finance has been initiated in Turkey. National and international events will be organized for development and promotion of the system.	• Initiatives generally are presented for of a marketing blitz. While most countries agree on this strategy, there is disagreement on who should be responsible for this. • Later in this report we will address who should be responsible for initiatives.
Talent Development	• Build Islamic Finance human capital, Qatar. • Turkey Islamic finance human resource development in the country is identified as a weakness and needs to be addressed. • Build Islamic Finance human capital in Indonesia.	• Talent development includes building human resources. • This component is important for the growth of industry but there is no consensus on who should be responsible for this. • We will address this further in the report.

Chapter 3

Analysis of Member States

This report focuses on OIC member countries and looks at the macroeconomic factors of each member country in relation to the status and characteristics of the Islamic Finance industry in each member country. Each country analyzed is important to the Islamic finance industry and has been selected for its growth potential. Countries in bold are countries of heightened systematic importance, “the total Islamic banking assets in a country comprise more than 15% of its total domestic banking sector assets or holds at least 5% of the global Islamic banking assets and considers the Islamic banking segment as the criterion for systemic importance of Islamic finance, since about 80% of Islamic financial assets are held within the banking sector” (Islamic Financial Services Board, 2015). Their heightened importance to the Islamic finance industry stems from their higher growth potential. Because of increased systematic importance, an additional risk analysis will be carried out for each of these countries. The risk analysis will compare risk metrics for operating Islamic vs. conventional banks. The analysis can provide valuable insights to the competitiveness of Islamic banks.

Because of the nature of Islamic finance regions also play a major role in Islamic finance. Regions of systematic importance to Islamic finance are the ASEAN, MENA, and the Sub-Sahara region. Similar to countries of systematic importance an analysis will be carried out comparing risk metrics for operating Islamic vs. conventional banks in the region.

The selected countries in this analysis are:

- Indonesia
- **Malaysia**
- Pakistan
- Qatar
- **Saudi Arabia**
- **Turkey**
- Iran
- **UAE**
- Kuwait
- Bahrain
- Sudan
- Bangladesh
- Egypt
- United Kingdom

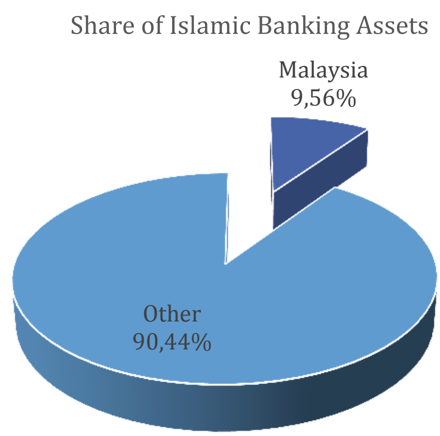
Figure 3.1: Map of Countries

3.1 Malaysia

Malaysia is the largest Islamic financial hub in the Asia-Pacific region. Malaysia is home to a wide range of investment, wholesale, retail, and structured products for a range of purposes and sectors. New innovations in the legal environment allow Malaysia to remain a strong producer in the Islamic finance industry.

The country also provides an efficient regulatory environment that is conducive for the Islamic financial services industries (IFSI). Under the existing legal framework, both conventional and Islamic financial systems coexist and work together harmoniously in a competitive environment (IFSB 2014).

Figure 3.2: Islamic Banking Assets, Malaysia



Source: IFSB 2015

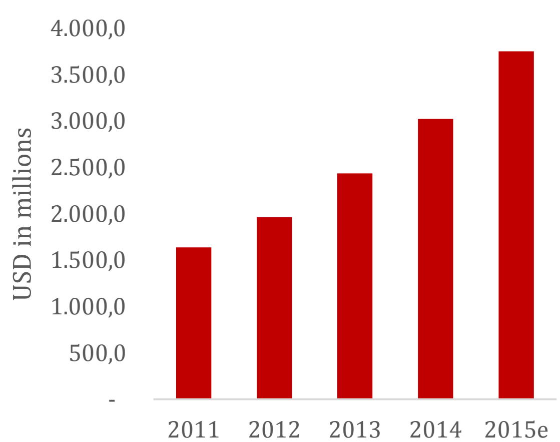
Legal:

In 1997, the Bank of Negara Malaysia established the National Shariah Council to advise Islamic banking institutions in Malaysia. Under the supervision of the Bank of Negara Malaysia, the Council advises Islamic Banking institutions on many aspects of banking operations. The Council has the ultimate authority to interpret and prescribe Islamic law as it applies to all Shariah business, Takaful, or other financial business.

Recently the Malaysia financial legal framework was overhauled by a new legal environment.

- **Central Bank of Malaysia Act** - The Central Bank of Malaysia Act of 2009 repealed its predecessor the Central Bank of Malaysia Act of 1958. The Act reinforces the power of the National Shariah Council in all Shariah business.

Figure 3.3: Gross Takaful contributions, Malaysia



- **Financial Services Act** – The Financial Services Act replaces many previous financial laws. It consolidates the regulatory and supervisory authority and framework for Malaysia's banking industry.

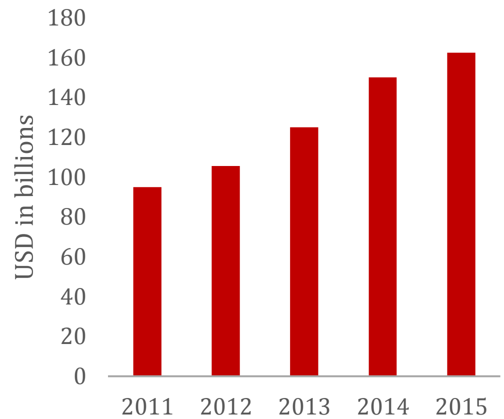
- **Islamic Financial Services Act** – This Act replaces the Islamic Banking Act of 1983 and the Takaful Act of 1984. The Islamic Financial Services Act introduced new governance procedures to strengthen Shariah governance and insure Shariah compliance.

Regulatory:

Malaysia is a leader in the global Islamic financial services industry. The major regulatory institutions are the Bank of Negara Malaysia, National Shariah Council, Securities Commission, Bursa Malaysia (Bursa), and the Labuan FSA. As seen from the legal environment the Bank of Negara Malaysia and the National Shariah Council work harmoniously to ensure compliance with Islamic law. The Securities Commission regulates Malaysia's capital markets and the Bursa Malaysia provides and operates the securities exchange.

Conventional and Islamic Institutions follow the Malaysian Accounting Standard Board (MASB). The independent institution seeks to guide the implementation of accounting standards by the Islamic finance industry. The standards are in compliance with the International Financial Reporting Standards (IFRS).

Figure 3.4: Total Banking Assets in Malaysia



Shariah:

The National Shariah Council under the supervision of the Bank of Negara Malaysia is the ultimate authority for Shariah matters pertaining to Islamic Finance. Recently, the Securities Commission revised Shariah screening methodology to screen stocks on both financial and business activity. The change requires all business in Malaysia to seek funding in a Shariah compliant manner. The change brings Malaysia closer to global practices.

Infrastructure:

Malaysia's infrastructure is the model of advances in Islamic banking. Malaysia has one of the few trading platforms to facilitate financial transactions. Malaysia has both an Islamic capital and money market. Malaysia's Islamic finance infrastructure is so advanced they are competitive in other regions.

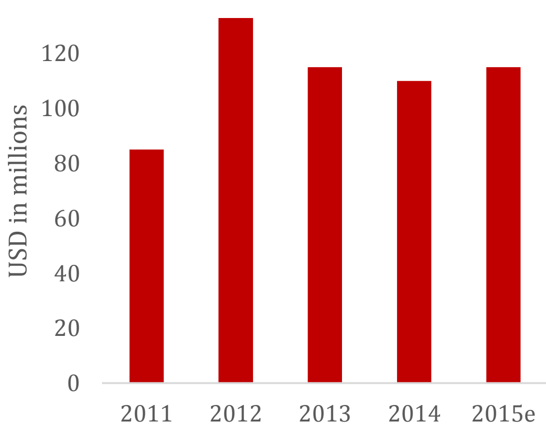
Product and Services:

The Malaysian capital markets hold over $ 500 million USD in assets and regulators expect this number to increase rapidly. New Islamic finance innovations come to Malaysia frequently. Recently Malaysia has released Basel III Tier 2 sukuk. The AmIslamic sukuk in Malaysia became the first sukuk to utilize murabaha, a Shariah compliant contract.

Products Malaysia offers include:

- Depository Services
- Financing
- Sukuk

Figure 3.5: Sukuk Issuance, Malaysia



- Investment
- Hedging
- Liquidity Management

Initiatives:

Malaysia is not complacent as a leader in Islamic finance. The regulatory agencies and government continue to push more reforms that will ensure Malaysia is a leader in Islamic finance for the near future.

Talent Development:

Because Malaysia is a leader in Islamic finance, they actively develop good Islamic banking talent. The Malaysian government is actively involved in the development of education in Islamic finance. They support specialized institutions and encourage overseas development and collaboration.

Universities in Malaysia offering training in Islamic Banking are[11]:

- INCEIF
- International Islamic University Malaysia
- UCSI University

Risk Analysis

This section presents a comparative analysis of the risk matrices for Islamic and conventional banks in Malaysia. This country has been chosen because of its importance to Islamic finance and its potential for growth. The following sections will compare risk indicators of Islamic banks against peer institutions.

Malaysian Banking Sector

The following analysis uses data from 18 Malaysian Islamic banks for which data is available on the BankScope database. The banks are:

- Affin Islamic Bank Berhad
- Al Rajhi Banking & Investment Corporation (Malaysia) Berhad
- Alkhair International Islamic Bank Berhad
- Alliance Islamic Bank Berhad
- AmIslamic Bank Berhad
- Asian Finance Bank Berhad
- Bank Islam Malaysia Berhad
- Bank Kerjasama Rakyat Malaysia Berhad
- Bank Muamalat Malaysia Berhad
- Bank Muamalat Malaysia Berhad
- CIMB Islamic Bank Berhad
- Hong Leong Islamic Bank Berhad
- HSBC Amanah Malaysia Berhad
- Kuwait Finance House (Malaysia) Berhad
- Maybank Islamic Berhad
- OCBC Al-Amin Bank Berhad
- Public Islamic Bank Berhad
- RHB Islamic Bank Berhad
- Standard Chartered Saadiq Berhad

[11] Source: *Simply Sharia Human Capital*, http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/, *All schools listed are Universities unless otherwise denoted.*

Average total assets in the Malaysian Islamic bank sample is 9,727 million USD, average employees of 2,134, 65 branches and average total business volume of 10,274 million USD.

Asset quality ratios – (Figure 3.6)

For the Malaysian banking sector, the Asset Quality for the Islamic bank loan portfolio is rather poor, compared to those of their conventional counterparts. Average Loan Loss Res/Gross Loans ratios and average loan loss reserve over net Int Rev for the Islamic banks are 5.61% and 27.22%, which are higher than those of their conventional counterparts of 1.62% and 8.42%, respectively.

Capital Adequacy ratios – (Figure 3.7)

Islamic banks in Malaysia, in general, maintain comparable capital adequacy to their conventional bank peers. Islamic banks have a lower equity / net loans ratio and equity / liabilities ratio, 41.21 and 14.58 respectively, to their conventional peers, 24.16 and 57.45.

Operational Efficiency ratios – (Figure 3.8)

Chart 3.15 shows that Malaysian Islamic banks have comparable net interest margins and net interest revenue to average assets. Conventional banks in Malaysia tend to pay out more dividends compared to their Islamic peers.

Liquidity Ratio – (Figure 3.9)

An Interbank Ratio of greater than 100 indicates that the bank is a net lender, rather than a borrower and resembles higher liquidity. Both Islamic and conventional banks are, in general, borrowers in the interbank market, but Islamic banks borrow more. For the Islamic banks, Net loans to total assets (69.29%) is higher, compared to those of conventional banks of 51.96%.

Figure 3.6: Asset Quality Ratios for Malaysia

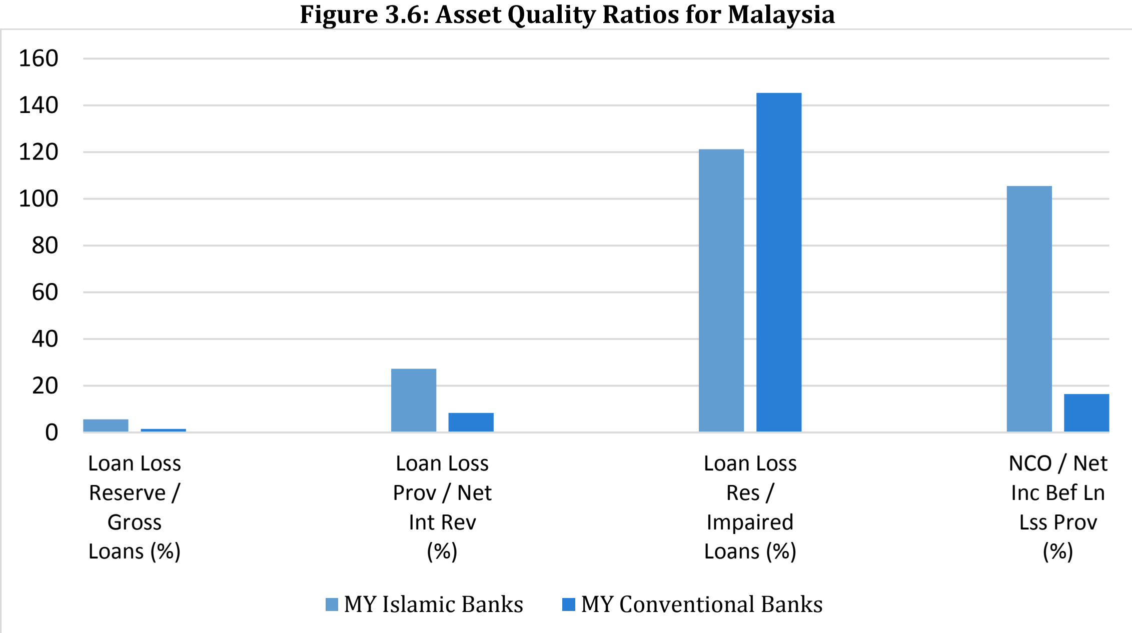


Figure 3.7: Capital Adequacy Ratios for Malaysia

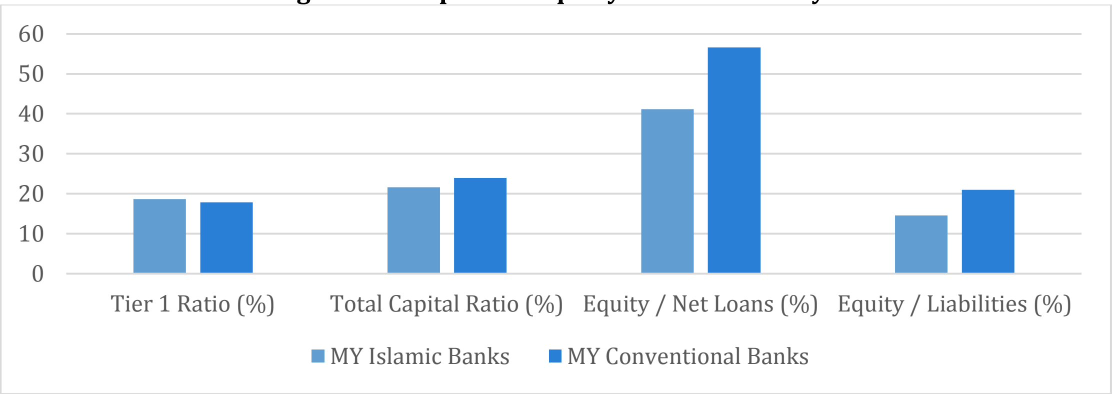


Figure 3.8: Operational Efficiency Ratios for Malaysia

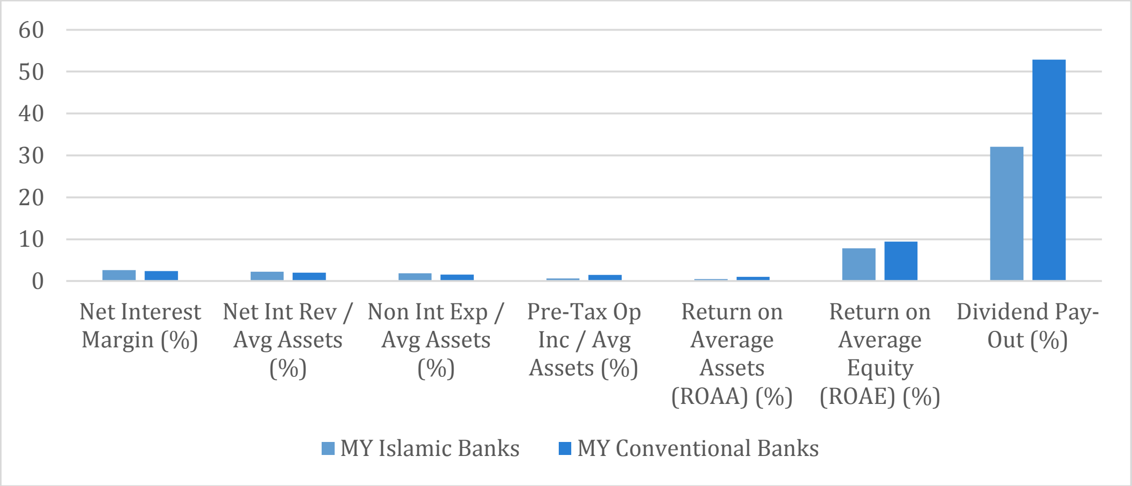
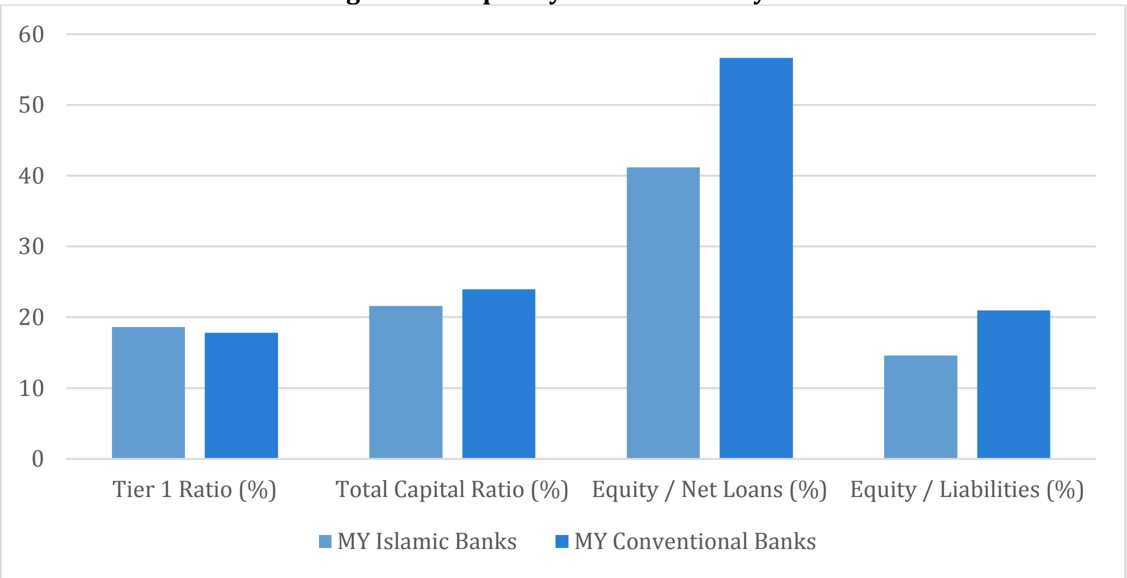


Figure 3.9 Liquidity Ratios for Malaysia



3.2 Pakistan

Legal:

The State Bank of Pakistan provides framework, research, and guidance for Shariah compliant Islamic business. In 2014, the State Bank of Pakistan released the Shariah Governance Framework in an effort to provide a baseline Shariah compliant environmental framework.

Regulatory:

Islamic banking activities are on the rise in Pakistan. The Central Bank of Pakistan acknowledged this and now has a dedicated deputy governor who focuses on Islamic banking. The State Bank of Pakistan is active in researching and promoting Islamic banking activity in Pakistan. In 2014, the Central Bank released a 5-year strategic plan aimed at helping Islamic banking Institutions.

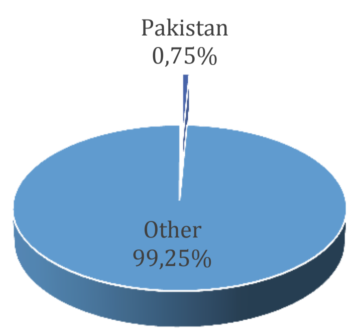
Shariah:

Pakistan has established a national Shariah Advisory Council at the state bank that acts as the ultimate authority for Shariah matters. All Islamic financial institutions must have Shariah advisors to ensure Shariah compliance at a working and operational level.

Infrastructure:

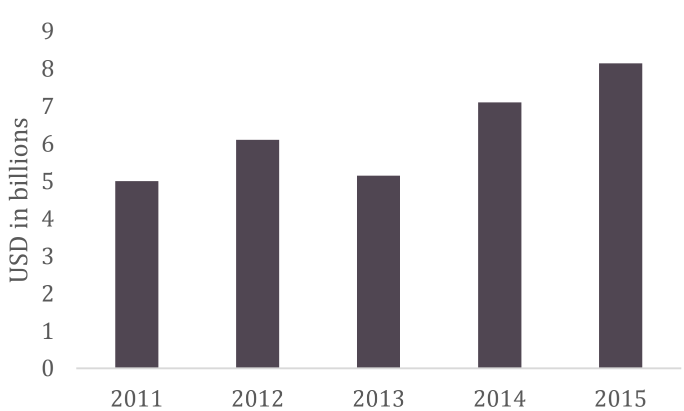
Pakistan has a long history of developing infrastructure to support Shariah compliant banking services. However, the industry suffered from slow to moderate growth. A new change in government in 2013 has led to a reinvigorated surge in Islamic banking activities. There still is huge potential in the Pakistan market for Islamic banking services.

Figure 3.10: Share of Islamic Banking Assets



Source: IFSB 2015

Figure 3.11: Total Banking Assets, Pakistan



Product and Services:

The dissemination of new Islamic banking services in Pakistan is slow. Recently the Securities and Exchange Commission of Pakistan has allowed insurance companies to issue Takaful. However, of the 50 conventional insurers less than half now issue Takaful products. Even with slow growth of new banking services, Pakistan's Islamic

Banking industry offers a wide array of Shariah compliant products.

Shariah compliant Islamic banking product and services offered in Pakistan include[12]:

Asset Side:

- Corporate / Commercial
- Agriculture
- Consumer
- Commodity Financing
- SME sector
- Treasury & Financial Institutions.

Liability Side:

- Current Accounts
- Basic Banking Account
- Savings Accounts
- Term Deposits of various maturities
- Certificates of Investment etc.

Others include:

- Bonds & Guarantees
- Letters of Credit
- Remittances (local & International)
- Online banking
- ATM/debit card (including Visa)
- Safe deposit lockers and
- Utility bill payments etc.
- Collection of export bills, assignment of export / local bills
- Inter-Bank funds transfer facility through ATM
- E-Statement facility
- Lockers
- Phone Banking and 24 /7 Call Centre service
- Deposit accepting ATMs

Initiatives:

The Islamic Bank of Pakistan has released a new strategic plan for 2014-2018. The plan shows the desire of the bank to convert Islamic banking as an "alternative" to a more mainstream investment. The plan to create a more mainstream Islamic finance community includes plans for a more favorable legal framework and incentives.

[12] Source: The State Bank of Pakistan.

Talent Development:

Islamic banking talent in Pakistan has been identified as a weakness. This is a major challenge to the growing industry. The creation of new university programs aimed at Islamic finance should improve both the Islamic finance workforce and future growth of Pakistan.

Universities in Pakistan offering training in Islamic Banking are[13]:

- Al-Huda CIBE
- Iqra University
- Institute of Business Management (IOBM) (Institute)
- International Islamic University
- National University of Science & Technology (NUST)

Key Islamic Finance Initiatives:

Table 3.1: Key Pakistan Islamic Finance Initiatives	
Key Initiative	**Action Plan**
"The most important building block for sustainable growth and development of Islamic banking is the enabling legal framework. (Strategic Plan, Pakistan 2014)" The current legal framework is not adequate to provide the support necessary for future industry growth.	• A new Alternate Dispute Resolution Mechanism has been developed to more efficiently resolve disputes. • Amendments have been made in tax laws to facilitate Islamic banking. • A new liquidity management framework is being developed.
Pakistan lacks the proper Sharia compliance measures for proper growth. A new framework will be developed.	• Issuance of Comprehensive Shariah Governance Framework. • Product Standardization and Harmonization.
A new awareness campaign will be launched to increase the public's perception of Islamic finance.	• New strategies will increase awareness. • The capacity of the Islamic banking infrastructure will also be expanded to meet growing demand.
New products and innovation will increase demand and interest in Pakistan's Islamic banking industry.	• Initiatives to develop housing finance products will begin. This will include rentals and purchase. • New strategies for SMEs and Islamic Microfinance will help increase demand and innovation.

[13] Source: *Simply Sharia Human Capital,* http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/, *All schools listed are Universities unless otherwise denoted.*

3.3 Turkey

Turkey has a developed financial market with a large potential consumer base for the Islamic financial services industry. Turkey is home to a diverse option of deposit and financing facilities for both corporate and commercial clients. The Islamic capital markets remain relatively young. Participation banking is the main source of Islamic banking in the country. The country has a regulated stock exchange that has both sukuk and Shariah-compliant ETFs listed.

Turkey is a key bridging economy between Asia and Europe. Turkey already has a developed conventional financial sector. The country is now beginning to develop a serious consumer-driven Islamic financial sector. It is general consensus that Turkey has an underdeveloped Islamic financial services market. If developed, Turkey has good prospects for the evolution of Islamic banking.

Legal:

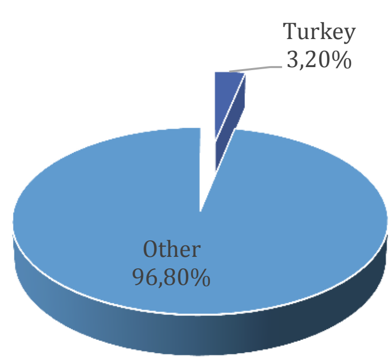
Shariah-compliant banking was introduced to Turkey in 1983. It has grown to nearly [asset], about 5-7 percent of total banking in Turkey. Key legislation influencing the Islamic Financial sector are:

- Banking Law No. 5411
- Banking Law No. 4389 (abolished by Law No. 5411)

No. 4389 created the Union of Private Finance Houses. This Union was used to strengthen banking regulations and create new state oversight for the private finance sector.

In 2005, 5411 Banking Law converted Islamic banks from "special finance" to participation banks. Participation banks collect deposits from customers and lend like a traditional bank. However, funds are lent interest-free and profits and loss are shared with depositors.

Figure 3.12: Share of Islamic Banking Assets, Turkey



Source: IFSB 2015

Participation and conventional banks are operating under the same laws (Banking Law 5411) and supervised by Banking Regulation and Supervision Agency (BRSA). On the other hand, there are secondary regulations pertaining to participation banks.

Like conventional banks, the participation banks are subject to Central Bank of the Republic of Turkey (CBRT) Law and regulations regarding foreign currency operations and reserve requirements.

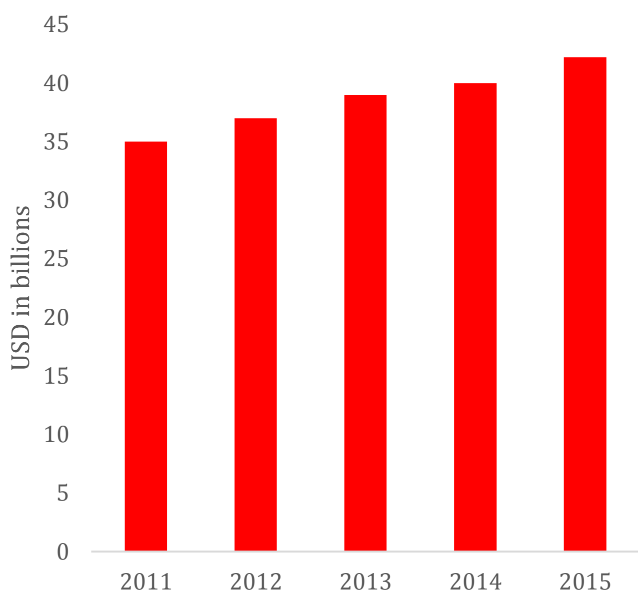
The deposit insurance scheme which is operated by independent public institution “Savings Deposit Insurance Fund” also covers the participation banking sector. Participation funds belonging to real persons up to 100.000 TRY in the participation banks are insured by Turkish government.

Regulatory:

Participation banking has been in Turkey for a number of years. However, more active government support is speeding up the growth of the industry. The government has begun supporting major initiatives that support growth and encouraging institutions to offer full-fledged Islamic financial services.

In order to remove fragmented structure in the field of accounting by ensuring an effective auditing and public oversight system, the Public Oversight, Accounting and Auditing Standards Authority (POA) was established in November 2011, by Statutory Decree No. 660. The POA is a public legal entity responsible for accounting standards with administrative autonomy and it is affiliated with the Ministry of Finance.

Figure 3.13: Total Participation Banks Assets, Turkey



Turkish Treasury is responsible for regulating and supervising the insurance and private pension system covering takaful operators and participation pension funds. Turkey's current insurance legislations offer a leveling playing field for takaful and participation pension funds.

Shariah:

Shariah compliance in Turkey is now a decision procedure performed by each institution internally. The Turkey government has not provided criteria to establish a Shariah board. Two public Islamic banks (Ziraat Participation Bank and Vakıf Participation Bank) started operating in 2015 and 2016, respectively.

Infrastructure:

Turkey already has a well-established capital market and regulated stock exchange. The market already supports both sukuk and Shariah compliant Exchange Traded Funds. Also traded on the money market are revenue partnership certificates. The certificates are Shariah compliant revenue partnership certificates for participation banks. The momentum of new Islamic finance regulations indicates that regulatory framework for full Takaful operations will broaden the scope.

Products and Services:

Banking products are rapidly expanding in the Turkish market. Turkey forecasts its Shariah compliant assets to account for 15% of the banking industry by 2023. Sukuk issuance is active in the market, not only corporate but also sovereign type. Turkey's first sukuk was issued by Kuveyt Türk participation bank in 2010. As of February 2016, corporate Sukuks issuances are totaling to approximately 5 billion US dollars. On the sovereign side, Turkey issued its first sovereign sukuk in international markets in 2012 and as of February 2016, sovereign sukuk issuances have exceeded 9 billion US dollars. With the government providing actively providing support, more Islamic financial services should be available soon.

Initiatives:

The government has provided support and the market is responding well. In order to develop participation banking and insurance as well as the interest-free finance system in general, and to contribute to Turkey's vision of becoming an international finance center, "Interest-Free Finance Coordination Board" was established in December 2015. Chairman of the Board is the Minister responsible for the Undersecretariat of Treasury. At this time Turkey seems poised to have major growth in Islamic financial services.

Talent Development:

Turkey is a well-developed and educated country. Most Universities conduct research relevant to the area of Islamic Finance. Accordingly, in four universities Islamic finance master and doctorate degrees are now available and even a university received permission to open undergraduate program in 2016. Government's and the Participation Banks' Union announced plans include specific actions for talent development.

Existing National Strategy

Table 3.2: Key Turkey Islamic Finance Initiatives

Key Initiative	Action Plan
A publicity campaign to promote interest-free-free finance has been initiated. National and international events will be organized for development and promotion of the system.	• A new public campaign will promote Islamic finance in the country. • Regulation agencies will meet in an international panel to support interest-free finance. • New social projects will play an important role in public campaign.
Islamic finance human resource development in the country is identified as a weakness and needs to be addressed.	• Scholars will focus on the development Turkish interest-free finance literature. • The development of new Islamic finance courses will be developed at Turkish Universities. • A new certification program in interest-free finance will help rapid human resource development.

The country lacks proper infrastructure for rapid interest-free finance development. A more proper infrastructure for development will be created.	• A "Legislation Committee" will be formed under the coordination of the Banking Regulation and Supervision Agency. The agency will ensure that all sector institutions shall be subject to the same regulations on the same issues, and to find solutions where regulations related to interest-free finance differ from the conventional system and make regulations. • New state participation banks will be created. • Advisory boards within interest-free finance institutions will be institutionalized.
Increase the diversity of interest-free financial products and services.	• The “diminishing mushakarah" product will be enhanced. • Projects developed by the Undersecretariat of Treasury such as angel investors will be funded by participation banks by using mudarabah/mushakarah method.

Risk Analysis

This section presents a comparative analysis of the risk matrices for the Islamic and conventional banks Turkey. This country has been chosen because of its importance to Islamic finance and their potential for growth. The following sections will compare risk indicators of Islamic banks against peer institutions.

Turkish Banking Sector

The following analysis consists of 4 Turkish Islamic banks for which data is available on the BankScope database. The banks are:

- Albaraka Turk Participation Bank-Albaraka Turk Katilim Bankasi AS
- Kuveyt Turk Katilim Bankasi A.S.-Kuwait Turkish Participation Bank Inc
- Asya Katilim Bankasi AS-Bank Asya
- Turkiye Finans Katilim Bankasi AS

Average total assets for the Turkish Islamic bank sample is 11,343 million USD, with average number of employees 3,723. Islamic banks an average number of 117 branches.

Asset Quality – (Chart 3.14)

Based on the available banks in Bankscope Loan Loss Prov / Net Int Rev and NCO / Net Inc Bef LN Loss is higher for Islamic banks compared to their conventional peers. This would indicate that Islamic banks in Turkey suffer for a lower quality loan portfolio than their conventional peers.

Capital Adequacy Ratios – (Chart 3.15)

Based on Chart 3.18, Islamic banks in Turkey maintain an adequate cushion of capital compared to their conventional peers. In all measures observed Islamic banks have higher ratios then their conventional peers.

Operational Efficiency Ratios – (Chart 3.16)

From an operational efficiency perspective Islamic banks in the Turkish region have mixed signals. They have a negative Return on Average Assets (-.4%) and a negative Return of Adv Equity (-2.76%). This would indicate there is a lot of work still to do in the Turkish region. However, Islamic banks pay out far more dividends than conventional banks in the region, 5.45% for Islamic banks and .02% for conventional.

Liquidity Ratios – (Chart 3.17)

Islamic banks in the Turkish region tend to be more liquid than their conventional counterparts. A high Interbank ratio (179.67%) indicates that Islamic banks are net lenders. Only by one measure do conventional banks have a higher measure, Liquid Assets / Dep & ST Funding (21.28 for Islamic banks and 25.26 for conventional banks.

Figure 3.14: Asset Quality Ratios for Turkey

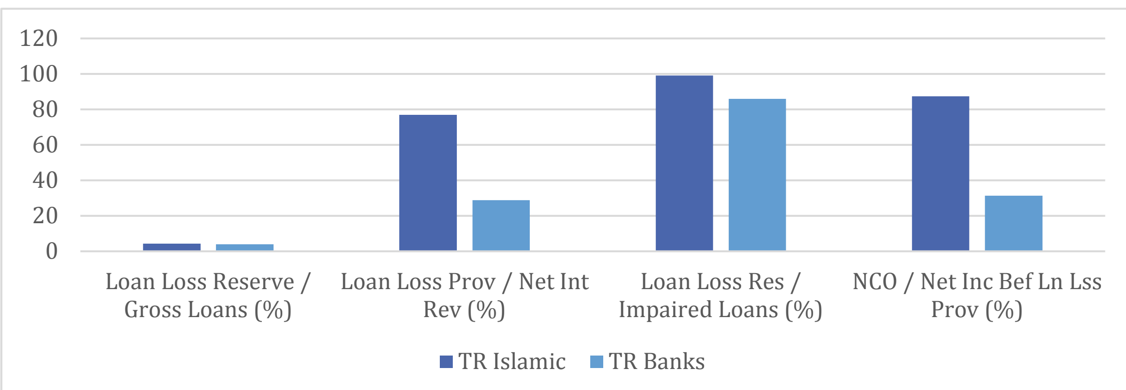


Figure 3.15: Capital Adequacy Ratio for Turkey

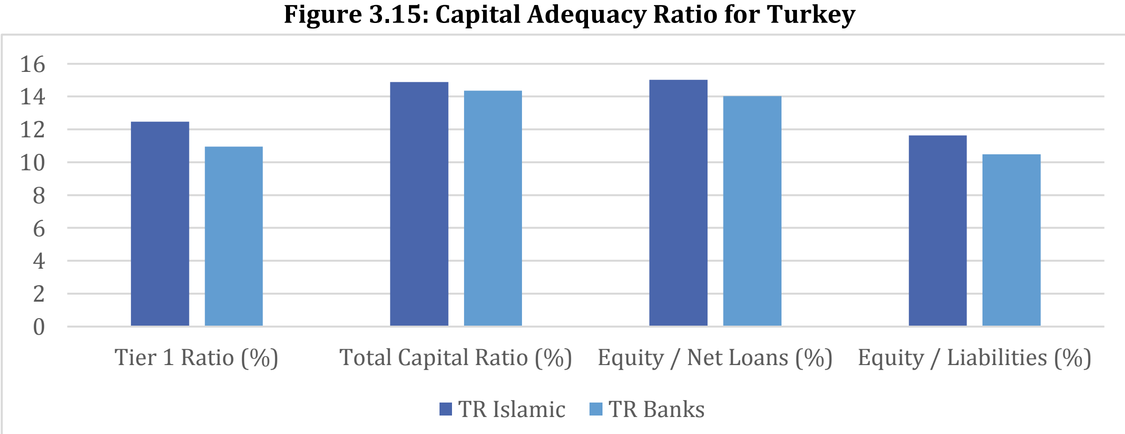


Figure 3.16: Operational Efficiency Ratios for Turkey

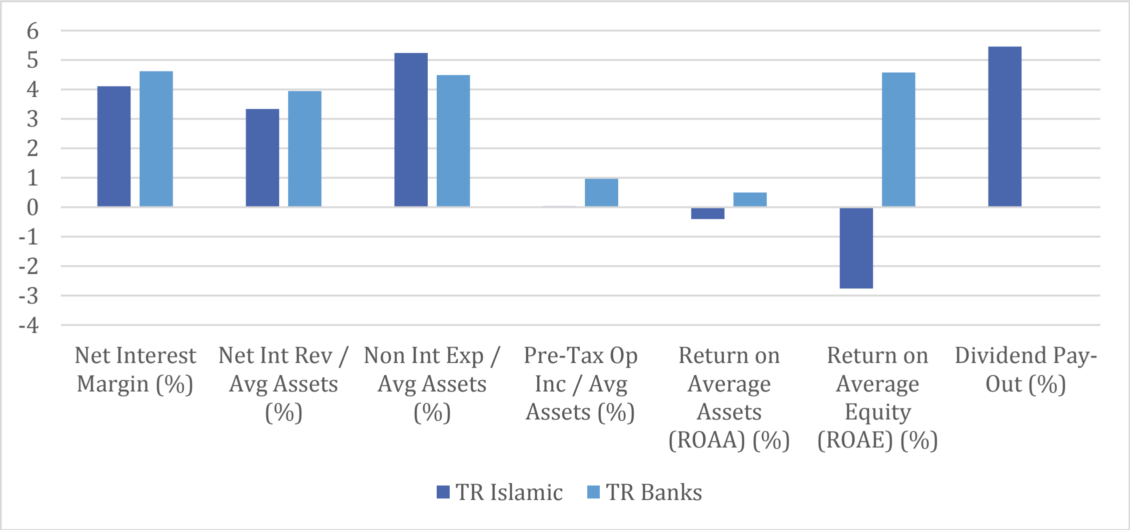
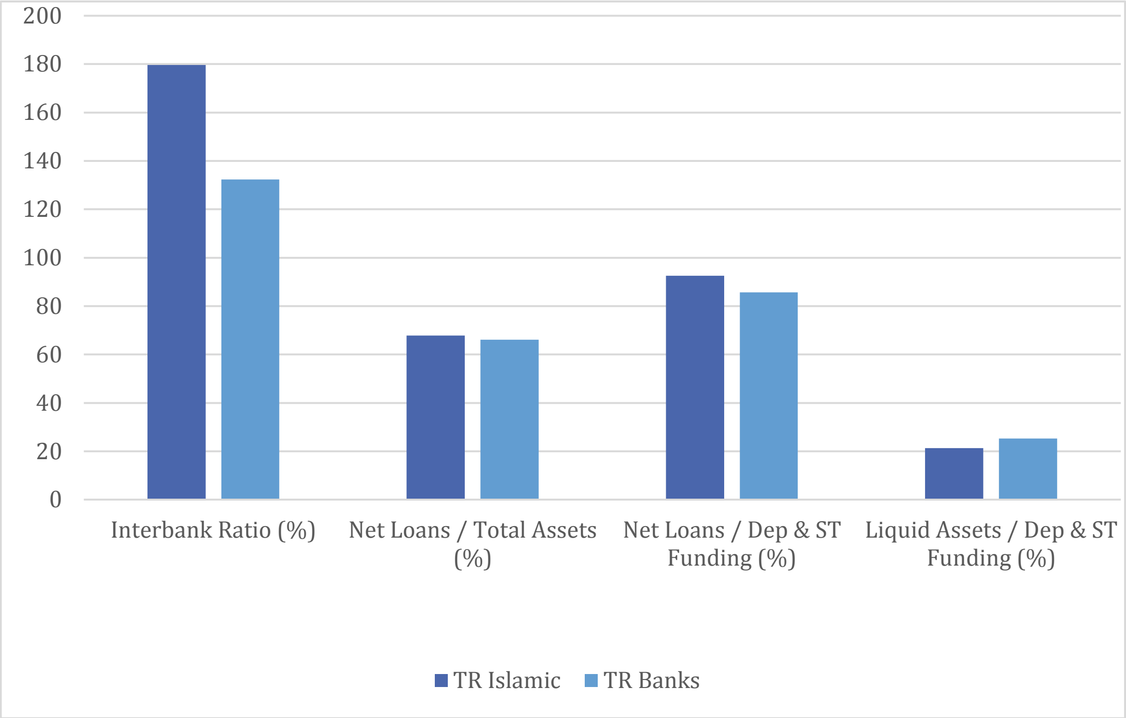


Figure 3.17: Liquidity Ratios for Turkey



3.4 United Arab Emirates (UAE)

The UAE is Located in the Gulf region. The UAE has provided a vibrant environment for the growth of Islamic financial services. The country has a relatively comprehensive regulatory environment to promote Islamic finance. More recent developments in the Islamic banking sector are aimed at innovating instruments to cater for market demand, especially Shariah-compliant liquidity instruments. The United Arab Emirates is a major player in the Islamic banking industry. Not only does Islamic banking thrive domestically, but also efforts by the UAE ruling families to strengthen the industry internationally are showing positive signs of progress

Legal:

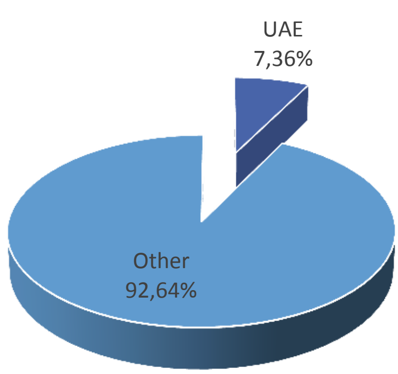
The banking industry in the United Arab Emirates is governed by the Central Bank of UAE. The power over the banking industry was established by the Union Law No. 10 in 1980. Because the official religion of the UAE is Islam, addition laws regarding Islamic financial business can be found in the Civil Code. Law No. 6 concerns Islamic banks and other Islamic financial institutions. This law provides the legal framework for Shariah compliance both domestically and abroad. Takaful was also governed by the Federal Law No. 6 until new legislation was passed in 2010 to further regulate the Takaful industry.

Regulatory:

The Dubai International Financial Center manages asset management, banking and credit services, securities, collective investment funds, custody and trust services, commodities futures trading, Islamic finance, insurance, several exchanges. The Center and its authority were established in 2004 with the passage of Dubai Law No. 9 of 2004.

The UAE requires all companies listed on most exchanges and all banks to publish IFRS financial statements.

Figure 3.18: Share of Islamic Banking Assets, UAE



Source: IFSB 2015

Shariah:

Because Islam is the official religion of the UAE Shariah law is embedded in much of the legal infrastructure. The Memorandum of Association of Islamic banks states that companies will form a Shariah Supervision Authority. This Authority consists of three members and they will be charged to ensure transactions and practices are in line with Shariah law.

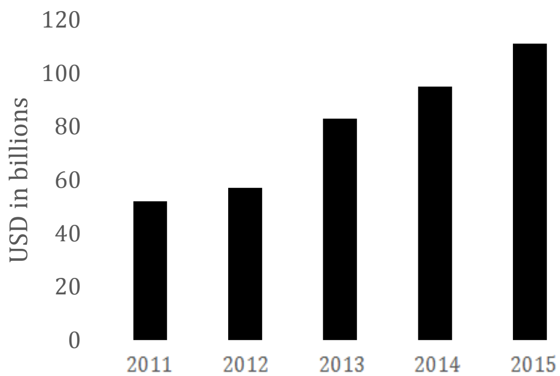
Infrastructure:

The infrastructure for Islamic services in the UAE is relatively advanced. Almost all Islamic services are supported by a legal and regulatory environment. Federal Law No. 6 requires a higher Shariah authority connected to the Ministry of Justice and Islamic Affairs. The authority will ensure Shariah compliance of Islamic financial institutions and their operations

Products and Services:

The products and services offered in the UAE are diverse. The diversity of these services is supported by the extensive Islamic regulatory and legal framework. The regulatory arms of the government regularly update infrastructure to Sukuk is regularly issued in the country to finance many different projects.

Figure 3.19: Total Banking Assets, UAE



Talent Development:

Universities & Institutes in the UAE offering training in Islamic Banking are[14]:

- Al Ghurair University
- Al Khawarizmi College
- Emirates Institute for Banking & Financial Studies (Institute)
- Ethica Institute of Islamic Finance (Institute)
- Hamdan bin Mohammed University
- Zayed University

Risk Analysis

This section presents a comparative analysis of the risk matrices for the Islamic and conventional banks the UAE. This country has been chosen because of its importance to Islamic finance and their potential for growth. The following sections will compare risk indicators of Islamic banks against peer institutions.

UAE Banking Sector

The following analysis consists of data from 7 UAE Islamic banks for which data is available on the BankScope database. The banks are:

- Dubai Islamic Bank PJSC
- Abu Dhabi Islamic Bank - Public Joint Stock Co.
- Emirates Islamic Bank PJSC
- Al Hilal Bank PJSC
- Noor Bank
- Sharjah Islamic Bank
- Ajman Bank

Average total assets of the UAE Islamic bank is 15,029 million USD. Islamic banks, have 46 branches.

[14] Source: *Simply Sharia Human Capital,* *http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/, All schools listed are Universities unless otherwise denoted.*

Risk Matrices

Asset Quality Ratios – (Figure 3.20)

All asset quality ratios are similar for both Islamic and conventional banks. Loan Loss Reserves / Impaired Loans is higher for Islamic banks (105.55%) than for conventional banks (99.12%).

Capital Adequacy ratios – (Figure 3.21)

In general, Islamic banks in the UAE maintain lower capital compared to conventional banks. All four ratios are lower for Islamic banks than for conventional banks.

Operational Efficiency ratios – (Figure 3.22)

Operational efficiency for Islamic banks and conventional banks are comparable. Conventional banks have a higher average Return on Average Equity (13.53%) compared to Islamic banks in the region (11.21%). Islamic banks Dividend payout is higher on average (53.91%) compared to conventional banks in 36.74%.

Liquidity Ratios – (Figure 3.23)

Interbank ratios for both the conventional banks (271.43%) and Islamic banks (242.65%) in the UAE are greater than 100%, which means that both types of banks are net lenders and maintain higher levels of liquidity. Ratios of Net Loans / Cust & ST Funding and Net Loans / Tot Dep & Bor for Islamic banks (65.93% and 83.54%) are comparable to convention banks (64.22% and 86.91%). This indicates that Islamic banks maintain a similar liquidity structure to conventional banks.

Figure 3.20: Asset Quality Ratios for UAE

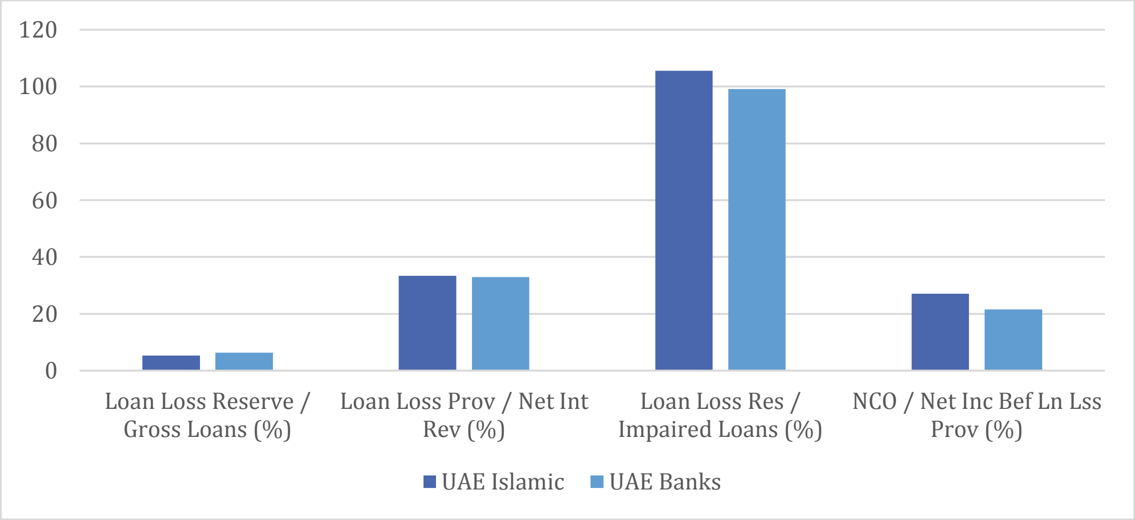


Figure 3.21: Capital Adequacy Ratio for UAE

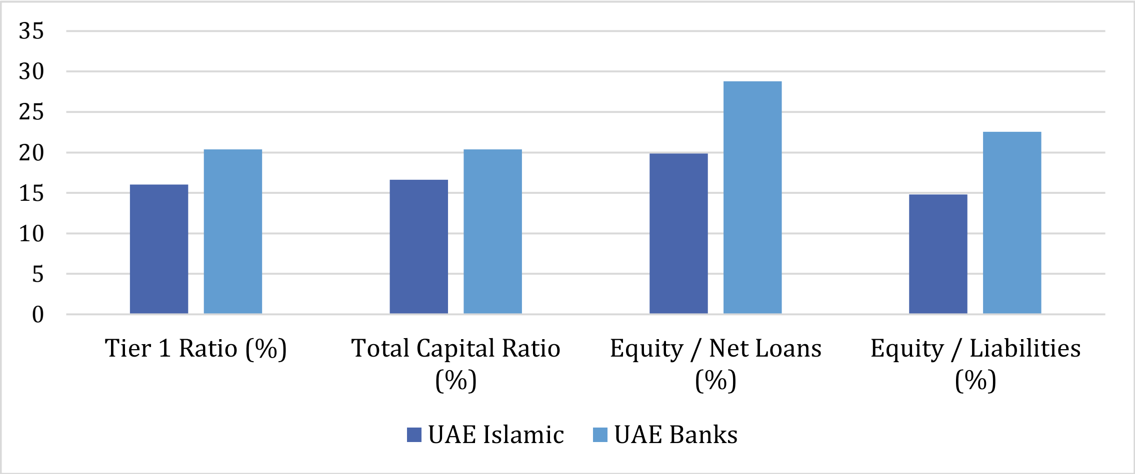


Figure 3.22: Operational Efficiency Ratios for UAE

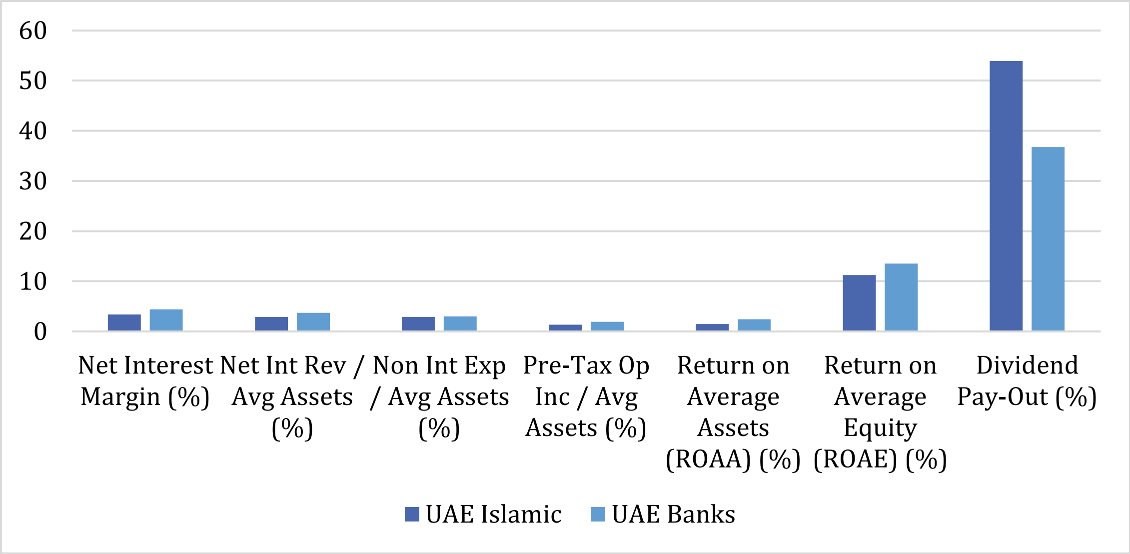
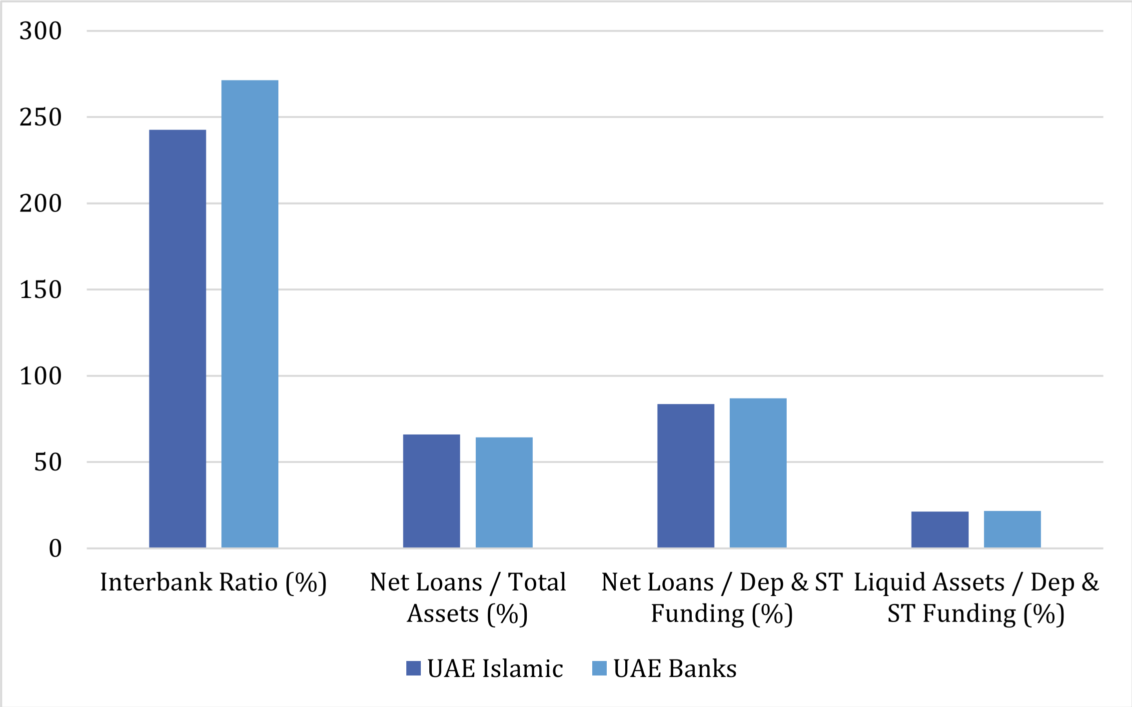


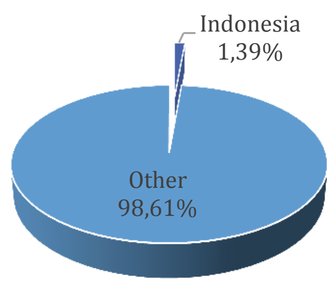
Figure 3.23: Liquidity Ratio for UAE



3.5 Indonesia

Indonesia has the world's largest Muslim population. The potential for Islamic finance to develop rapidly is high. Many experts expect in Indonesia to be a major player in the Islamic finance industry in the long term future.

Figure 3.24: Share of Islamic Banking Assets, Indonesia



Source: IFSB 2015

Legal:

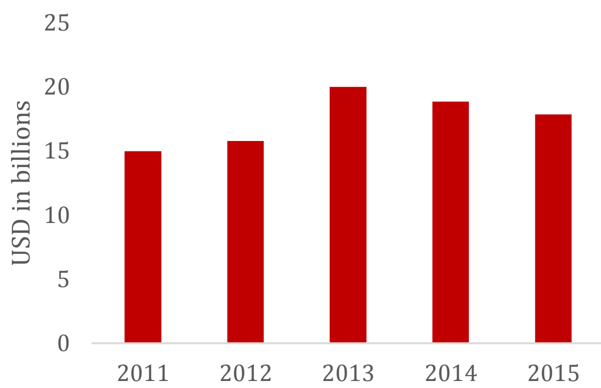
The central bank and banking regulator of Indonesia is The Bank Indonesia. The Bank Indonesia has regulations on Shariah banking committees, Shariah commercial banks, and Shariah business units. Capital markets are regulated by the Financial Services Authority of Indonesia. The Financial Services Authority of Indonesia replaced the Bapepam-LK in 2011. It regulates both conventional and Islamic transactions.

Regulatory:

Authorities in Indonesia plan to introduce a new legal framework to integrate Islamic banks into the global finance system. The plan will revise capital market requirements to make Indonesia banks in line with international standards.

Accounting systems are set forth by the Financial Accounting Standards Board overseen by the Institute of Accountants. The board issues statements of financial accounting standards for Shariah transactions. Most standards are compliant with the International Financial Reporting Standards.

Figure 3.25: Total Banking Assets, Indonesia



Shariah:

The Indonesian Ulama Council is the ultimate authority on Shariah matters. The religious degrees of the national fatwa council are incorporated into the Islamic banking regulations by Indonesian regulators.

Bank Indonesia requires Shariah banks have a Shariah Supervisory Board that ensures activities and operations are Shariah complaint.

Infrastructure:

Indonesia has infrastructure to support sukuk issuances and Shariah compliant business listings on the Indonesian Stock Exchange. The Jakarta Futures Exchange is a platform for trading of Shariah compliant products. The availability of this exchange allows Islamic banks to better manage liquidity.

Products and Services:

The Indonesian market supports a wide range of Islamic retain and corporate banking products. Car and housing financing, credit cards, and other wealth management products are available in the Indonesian marketplace.

Talent Development:

Indonesia offers talent development in many different types of specializations. There are Islamic finance research institutes located in Indonesia and also universities that offer Islamic finance specializations.

Universities & Institutes in Indonesia offering training in Islamic Banking are[15]:

- Airlangga University
- LPPI Indonesian Banking Development Institute (Institute)
- Paramadina Graduate School (Institute)

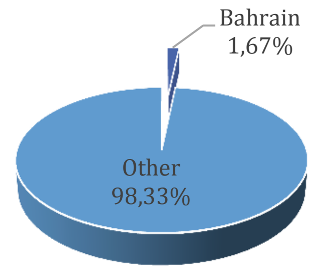
[15] Source: *Simply Sharia Human Capital,* (Central Bank of Bahrain)*All schools listed are Universities unless otherwise denoted.*

3.6 Bahrain

Bahrain established its first Islamic commercial bank in 1979, Bahrain Islamic Bank, and was the pioneer of the Gulf Cooperation Council.

Legal:

Figure 3.26: Share of Islamic Banking Assets, Bahrain



Source: IFSB 2015

The Central Bank of Bahrain is the general supervisory authority of banking in Bahrain. The Central Bank has jurisdiction over Islamic Banking, Takaful, and Capital Markets. Authority from the central bank is derived from its Central Bank of Bahrain Rulebook. Relevant Rulebooks to the Central banks authority over Islamic banking are as follows:

- CBB Rulebook Vol. 1 & 2 – Islamic Banking
- CBB Rulebook Vol. 3 – Takaful
- CBB Rulebook Vol. 4, 5, & 6 – Capital Markets

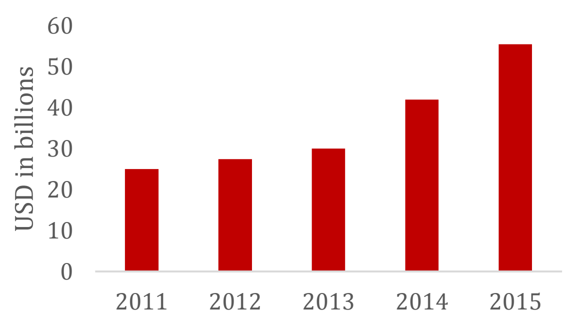
The rulebook for Islamic banks covers areas such as licensing requirements, capital adequacy, risk management, business conduct, financial crime and disclosure/reporting requirements.

Regulatory:

The Central Bank of Bahrain was developed in 2006. Prior to the creation of the central bank jurisdiction over the financial sector was held by the Bahrain Monetary Agency. The Central Bank of Bahrain also has authority over the Bahrain Stock Exchange. All Financial reporting standards in Bahrain are based on the International Financial Reporting Standards.

Shariah:

Figure 3.27: Total Banking Assets, Bahrain



The National Shariah Board of Bahrain is a branch of the Central Bank of Bahrain. The board was created to ensure and verify Shariah compliance with the banks own products. Other Islamic financial institutions operating in Bahrain must establish their own Shariah Supervisory Committee. Committee members may serve more than one financial institution. Law also requires banking institutions to comply with account standards for Islamic Financial Institutions standards No. 1 & 2.

Infrastructure:

Bahrain commitment to a complete regulatory infrastructure is evident. Bahrain has created various regulatory bodies to ensure a comprehensive regulatory environment. Bahrain is host to a number of organizations central to the development of Islamic finance

These institutions include[16]:

- Accounting and Auditing Organisation for Islamic Financial Institutions ('AAOIFI')
- Liquidity Management Centre ('LMC')
- International Islamic Financial Market ('IIFM')
- the Islamic International Rating Agency ('IIRA')
- Shariya Review Bureau.

Products and Services:

Because Bahrain is a hub for Islamic finance, the country has a very diverse portfolio of products and services.

A sample of services offered in Bahrain include:

- Retail banking
- Wholesale products and services
- Islamic treasury products
- Money market liquidity management alternatives

Bait Al Bursa was developed in 2011 as an Islamic division of the Bahrain Financial Exchange. It is the first dedicated platform in the region offering exchange traded solutions to the Islamic finance market.

Initiatives:

Bahrain is committed to many initiatives in Islamic finance. Bahrain is a pioneer of the Gulf Cooperation Council and other initiatives that make Bahrain Islamic banking competitive domestically and globally. The Central Bank of Bahrain has also recently established a special fund to finance research, education and training in Islamic finance, known as the Waqf Fund. More recent regulations focus on new rules governing Shariah advisory companies. The creation of these companies will allow more flexibility for small Islamic investment institutions to outsource the Shariah review process.

Talent Development:

Universities & Institutes in Bahrain offering training in Islamic Banking are[17]:

- AAOIFI
- Arab Open University
- Bahrain Institute for Banking & Finance (BIBF)
- Capital Knowledge
- Royal University for Women
- University of Bahrain
- University College of Bahrain

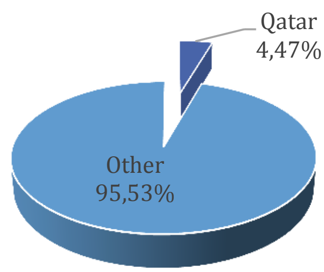
---

[16] Information gathered from the Central Bank of Bahrain, (CIA)

[17] Source: *Simply Sharia Human Capital*, http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/, *All schools listed are Universities unless otherwise denoted.*

3.7 Qatar

Figure 3.28: Share of Islamic Banking Assets



Source: IFSB 2015

Legal:

The Qatar Financial Center is the main governing body for financial services in Qatar. The authority of the Qatar Financial Centre comes from Law No. 7 of 2005 which provides the basic structure and authority of the QFC. The Qatar Financial Center has branches that assist in regulation of financial services.

Islamic banking rules are governed under:

- Islamic Finance Rulebook – Islamic Banking
- Prudential-Insurance Rulebook – Takaful
- Private Placement Scheme Rules 2010 – Capital Market

Regulatory:

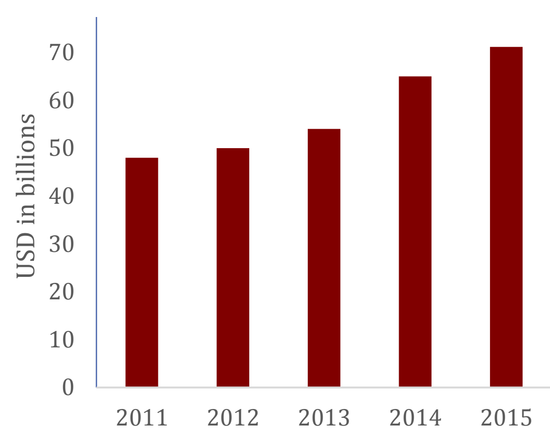
Recently Islamic banking regulators has advocated for more separation in conventional and Islamic banking assets. The response was positive there are now 4 full-fledged Islamic banking institutions in the country. Financial reporting in Qatar is based on the International Financial Reporting Standards.

Shariah:

The established rules under the Islamic Finance Rulebook require all firms establish a Shariah Supervisory Board consisting of no less than three members. The board is to ensure financial operations are Shariah compliant. The Central Bank of Qatar has a Supreme Shariah Council.

Infrastructure:

Figure 3.29: Total Banking Assets, Qatar



Support from the Qatar Financial Center and its branches support a robust infrastructure for Qatar Islamic finance. In 2013, a joint strategic plan for financial sector regulation was launched in Qatar by the Qatar Central Bank, Qatar Financial Centre Regulatory Authority, and Qatar Financial Markets Authority. The plan establishes a framework for regulating the financial sector across the State, setting out a roadmap of strategic priorities for the next three years. The strategic goals of the plan are enhancing regulation, expanding macro-prudential oversight, strengthen market infrastructure, protecting consumers and investors, promoting regulatory cooperation, and building human capital.

Products and Services:

Qatar offers a wide range of investment and banking services. Many different principles are used such as, Musawama, Murabahah, Ijarah, and Musharakah. Larger Islamic banks also provide advisory services and are active in Islamic capital markets.

Initiatives:

In 2008, Qatar launched the Qatar National Vision 2030 which aims to make Qatar an advanced country. Part of this vision includes a National Development Strategy and more research in Islamic Finance. Islamic banks have also show great interest in growing the Islamic Banking industry. Many banks support educational and social initiatives in the country

Talent Development:

Universities & Institutes in Qatar offering training in Islamic Banking are[18]:

- Qatar Faculty of Islamic Studies

Table 3.3: Key Qatar Islamic Finance Initiatives

Key Initiative	Action Plan
Enhance regulation and oversight framework for Islamic banking institutions. This will better prepare	1. Align the regulatory framework for banks with the Basel Core Principles and Basel III standards. Amendments have been made in tax laws to facilitate Islamic banking. 2. Unify corporate governance standards for banks and financial institutions by updating governance guidelines.
Strengthen market infrastructure.	3. Develop a new corporate debt market.
Build Islamic Finance human capital.	1. Establish a competency framework for the jobs in each of the three regulatory authorities. 2. Create a shared training program to start building a common set of core skills.

Strategic Plan:

Qatar has a national strategic plan for the growth of Islamic finance. They have several components mentioned in previous sections. Human capital, growing market infrastructure, and enhancing a legal and regulatory infrastructure are some of the highlights of their strategic plan for future growth. If they achieve the elements of their strategic plan they should see stronger Islamic financial services growth.

[18] Source: *Simply Sharia Human Capital*, http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/, *All schools listed are Universities unless otherwise denoted.*

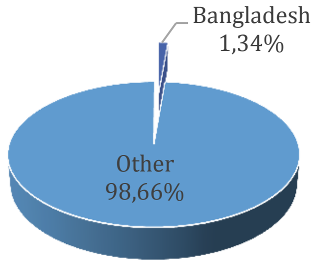
3.8 Bangladesh

The Islamic banking sector of Bangladesh has achieved a high growth. The share of banking assets held by Islamic banks in the country is estimated above 20%. Because Bangladesh is a majority Muslim country it is expected to grow more.

Legal:

The Bangladesh Securities and Exchange Commission regulates capital markets in Bangladesh. The Commission is a branch of the Ministry of Finance. The Commission was established in 1993 by the Securities and Exchange Commission Act of 1993. Islamic banks are required to follow the guidelines set forth by the Central Bank of Bangladesh.

Figure 3.30: Share of Islamic Banking Assets, Bangladesh



Source: IFSB 2015

Regulatory:

The Bangladesh Securities and Exchange Commission regulates capital markets in Bangladesh. The Commission is responsible for administering securities legislation. The Chairman and Members of the Commission are appointed by the government. The banking sector is regulated by the Central Bank of Bangladesh, established in 1971. The Bank is responsible for general central banking activities, such as, open market operations, banking sector regulation, managing the countries reserves. In 2014, the central bank recommended amendments to the existing Sukuk program to broaden its use. The new amendment would allow for a sovereign issuance.

Shariah:

There is strong potential for more development of Shariah compliant products in Bangladesh. More than 80% of Bangladesh is Muslim. In general practice each bank hosts their own Shariah board to ensure Shariah compliance.

Talent Development:

There is active talent development in Bangladesh. Because Bangladesh is a majority Muslim country there are many schools that focus on Shariah topics. Some schools offer degrees specifically in Islamic finance.

Universities & Institutes in Bangladesh offering training in Islamic Banking are[19]:

- Daffodil International University
- Darul Ihsan University
- Islami Bank Training & Research Academy (Academy)
- LCBS Dhaka (Institution)

[19] Source: *Simply Sharia Human Capital,* http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/, *All schools listed are Universities unless otherwise denoted.*

- The People's University of Bangladesh
- University of Dhaka

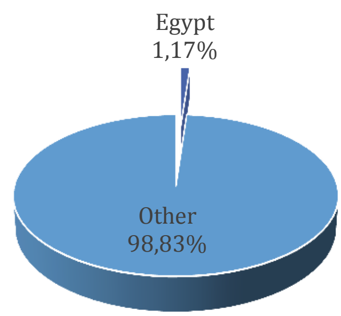
Strategic Planning:

Bangladesh is a majority Muslim country, Islamic finance is well known. However, Islamic finance still struggles to gain majority support throughout the country. Bangladesh could benefit the most from a national Islamic financial strategy. By following the framework from previous sections, Bangladesh could strengthen many of its weaknesses. Human capital development, product innovation, regulatory & legal framework, and a dedicated Shariah board will help foster growth in the Islamic financial sector.

3.9 Egypt

Egypt is the birthplace of modern Islamic Banking. However, Islamic finance has not been a focus of the country in recent history. Egypt holds lots of potential because it is a Muslim country with heightened sensitivity to Shariah.

Figure 3.31: Share of Islamic Banking Assets, Egypt



Source: IFSB 2015

Legal:

The financial environment in Egypt is managed by the Central Bank of Egypt and the Egyptian Financial Supervision Authority. The Central Bank of Egypt was established in 1961 and new legislation has consolidated non-banking regulation into the new Egyptian Financial Supervision Authority.

Regulatory:

Egypt's financial sector was recently unified. The passage of Law No. 10, passed in 2009, replaced three regulatory authorities: The Capital Market Authority, the Egyptian Insurance Supervisory Authority, and the Mortgage Finance Authority. The new regulatory authority is the Egyptian Financial Supervision Authority. The new Authority was a response to the financial crisis.

The Egyptian Financial Supervision Authority supervises all non-banking financial transactions and markets. The EFSA has authority over capital markets, derivative markets with underlying financial assets, insurance, and other retail products.

Banking activities are regulated by the Central bank of Egypt. The Central bank regulates the banking system, supervises the national payments system, and manages Egypt's public and private debt.

Talent Development:

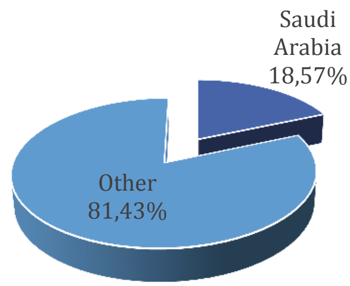
Talent development has historically been strong in Egypt. The oldest degree granting Islamic University in the world, Al Azhar University, is located there.

Universities & Institutes in Egypt offering training in Islamic Banking are[20]:

- Al-Azhar University
- Nile University
- The American University in Cairo

3.10 Saudi Arabia

Figure 3.32: Share of Islamic Banking Assets, Saudi Arabia



Source: IFSB

Saudi Arabia is a leader in Islamic finance. The Islamic Development Bank (IDG), based in Saudi Arabia, is one of the world's largest Islamic finance research bodies. The Bank has extended loans worth $100 Billion to member states since its inception. Saudi Arabia is increasing its use of Sharia compliant financing to fund government projects. Saudi Arabia is an oil-rich vibrant economy with an existing large market for Islamic financial services. Saudi Arabia is well positioned to be a leader in Islamic finance for the future.

Legal:

The central monetary agency in Saudi Arabia is the Saudi Arabian Monetary Agency. The Saudi Arabian Monetary Agency is responsible for overseeing all areas of the financial system of the country. Some responsibilities of the Saudi Arabian Monetary Agency are:

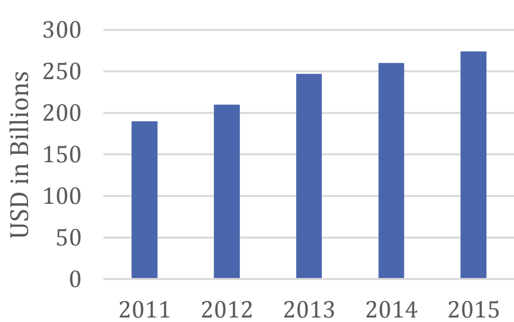
- Issuing the National currency Saudi Riyal.
- Banker to government.
- Supervision of commercial banks.
- Activities similar to a central bank.

The Capital Markets Authority is an independent government organization that regulates the Saudi capital market.

Regulatory:

The Saudi Arabian Monetary Agency regulates nearly all banking-related activities. All accounting standards for banks listed on a public Stock Exchange are International Financial Reporting Standards. All other companies must follow accounting standards set forth by the Saudi Organization for Certified Public Accountants.

Figure 3.33: Total Banking Assets, Saudi Arabia



[20] Source: *Simply Sharia Human Capital,* *http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/, All schools listed are Universities unless otherwise denoted.*

Shariah:

In Saudi Arabia there is no national Shariah board. Many banks have an internal Shariah Board and those boards general follow the standards of the Islamic Fiqh Academy. This means that no central bank must approve new financial products and no Shariah review for Shariah compliance.

Infrastructure:

The current Infrastructure of Islamic finance in Saudi Arabia is governed by the Saudi Arabia Monetary Authority. The Monetary agency controls both Islamic and conventional financial and banking services.

Products and Services:

New Islamic financial services are being developed in Saudi Arabia. The government has nearly one half billion dollars in infrastructure projects and some finance will come from Shariah compliant finance. Large projects are also being funding using Islamic finance. The King Abdullah Port, the first private fort in the Kingdom, signed $140 million USD Murabaha Bridge financing in 2014.

Initiatives:

The government established SAGIA, the Saudi Arabia General Investment Authority, to facilitate foreign investment. The center can issue license, get labor visas, and pay taxes in one location. SAGIA also can offer a number of incentives in order to attract investors. Some incentives offered by SAGIA are: 100% foreign ownership of companies and property, no minimal capital requirement, no restrictions on the repatriation of capital, and other tax incentives. To encourage development, the government has offered tax concessions in less developed areas.

Talent Development:

Universities & Institutes in Saudi Arabia offering training in Islamic Banking are[21]:

- Effat University
- King Abdulaziz University
- Islamic Research & Training Institute (Institute)

Risk Analysis

This section presents a comparative analysis of the risk matrices for the Islamic and conventional banks Saudi Arabia. This country have been chosen because of its importance to Islamic finance and their potential for growth. The following sections will compare risk indicators of Islamic banks against peer institutions.

Saudi Banking Sector

The following analysis consists of 5 KSA Islamic banks for which data is available on the BankScope database. The banks are:

[21] Source: *Simply Sharia Human Capital*, http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/, *All schools listed are Universities unless otherwise denoted.*

- Dubai Islamic Bank PJSC
- Abu Dhabi Islamic Bank - Public Joint Stock Co.
- Emirates Islamic Bank PJSC
- Al Hilal Bank PJSC
- Noor Bank
- Sharjah Islamic Bank
- Ajman Bank

Average total assets of the KSA Islamic bank is 31,063 million USD. Islamic banks in KSA employ an average of 4,914 workers across 199 branches.

Risk Matrices

Asset Quality Ratios – (Chart 3.34)

Chart 3.21 shows that, for the KSA banking sector, the Asset Quality for the Islamic banks' loan portfolio is comparable to that of their conventional counter parts. The Average Loan Loss Res/Gross Loans ratio for the Islamic banks is 1.94%, which is lower than that of their conventional counterparts of 1.89%. Islamic banks NCO / Net Inc Bef Ln Loss Prov is 18% compared to 9.14% for their conventional counterparts.

Capital Adequacy ratios – (Chart 3.35)

In general, Islamic banks in KSA maintain better capital adequacy, as evident by the capital adequacy ratios. All four ratios for Islamic banks are higher than their conventional peers. Higher Equity/Net Loans ratios for the Islamic banks (32.65%) reflects that Islamic banks more cushions to absorb losses on the loan books compared to conventional counterparts (22.9%). (See Chart 3.36)

Operational Efficiency ratios – (Chart 3.36)

In general, Islamic banks have very similar Operational Efficiency ratios as their conventional counterparts. The Return on Average Equity for conventional banks (14.75) is higher than Islamic banks (10.32). Chart 3.23 shows that Islamic banks in the KSA have a higher dividend payout ratio.

Liquidity Ratios – (Chart 3.37)

An Interbank Ratio of greater than 100 indicates the bank is net lender, rather than a net borrower and resembles higher liquidity. The sample of Islamic banks in the KSA are extreme net lenders. The Interbank Ratio for Islamic banks in the KSA is 547.49%. This ratio is higher than for any other country or region analyzed. Conventional banks also have a high interbank ratio 131.94. All other liquidity measures are comparable across Islamic and conventional banks.

Figure 3.34: Asset Quality Ratios for KSA

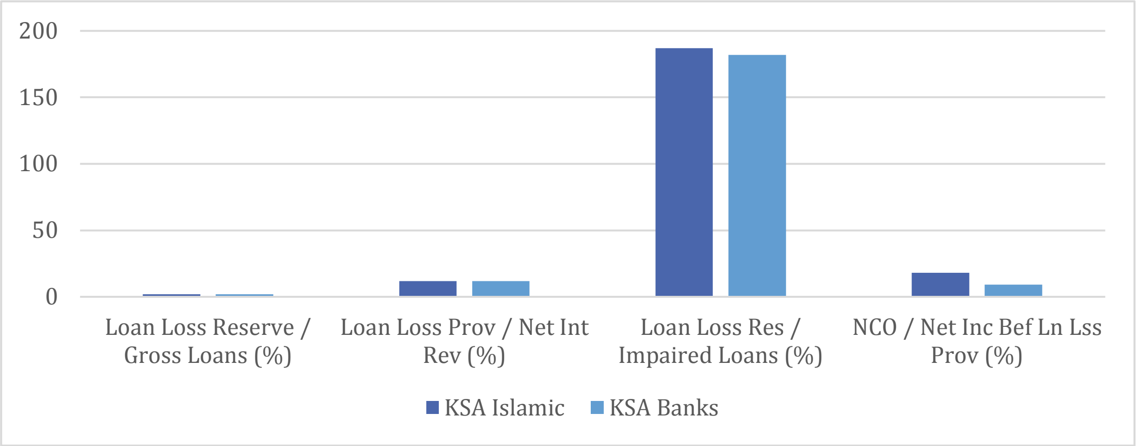


Figure 3.35: Capital Adequacy Ratio for KSA

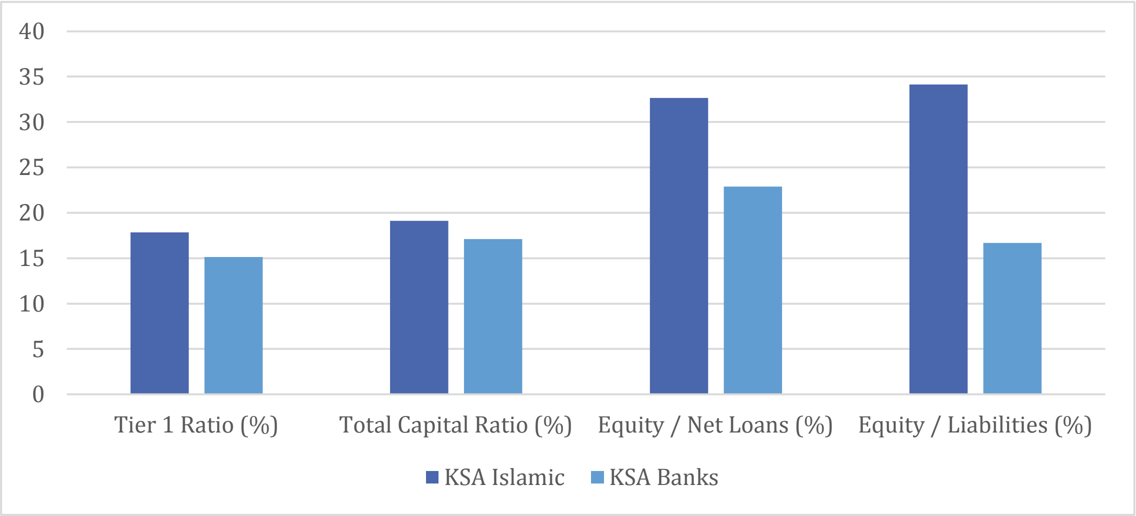


Figure 3.36: Liquidity Ratio for KSA

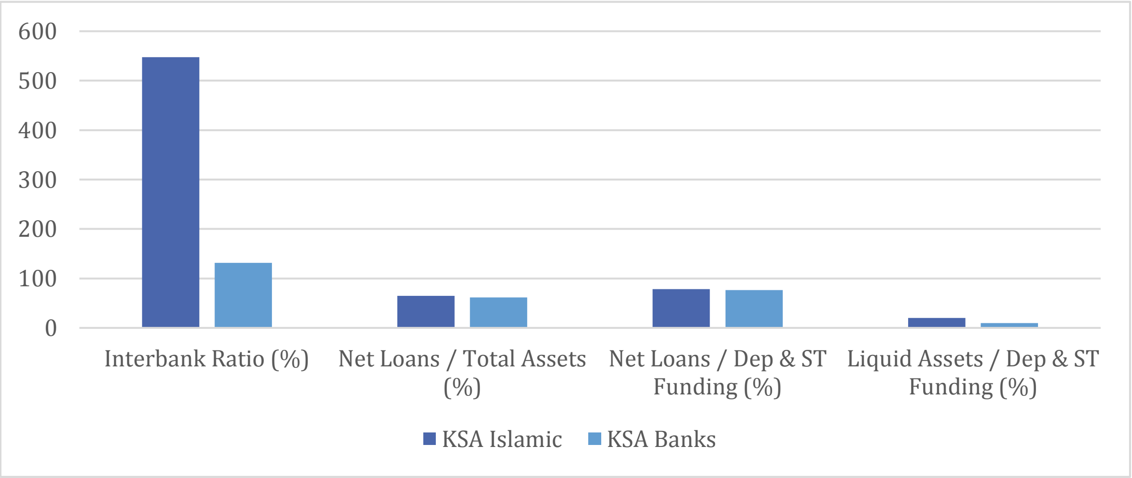
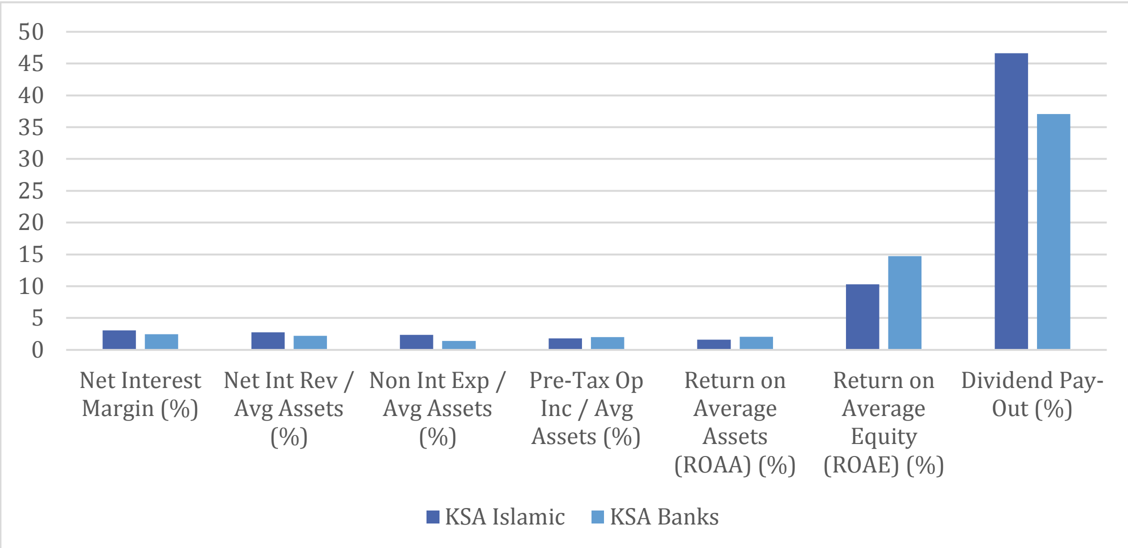


Figure 3.37: Operational Efficiency Ratios for KSA



3.11 Sudan

Sudan has a unique financial system; Sudan operates an Islamic banking system. In 2006, Sudan changed its system to allow areas of South Sudan to operate conventional banking practices. Growth in Sudan has been crippled by Civil Wars in the country. New microfinance initiatives can help the country grow.

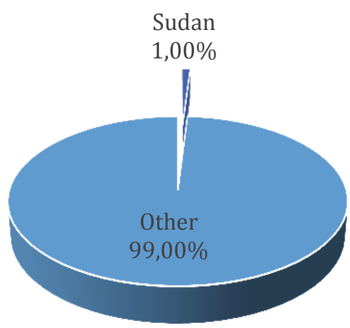
Legal:

The key regulations of Sudan include the Central Bank of Sudan Policies 2012 and the Bank of Sudan Act 2002. The Bank of Sudan Act in 2002 stipulates that the Bank of Sudan will abide by Shariah principles.

Regulatory:

The major regulatory authorities in Sudan include: The Central Bank of Sudan, The High Shariah Supervisory Board, and the Khortoum Stock Exchange. The Central Bank of Sudan manages and conducts open market operations related to Sudan's exchange rate policy. The Khortoumn Stock Exchange oversees the non-banking financial system services industry. The exchange regulates all investment products and provides financial education.

Figure 3.38: Share of Islamic Banking Assets, Sudan



Source: IFSB 2015

Shariah:

The High Shariah Supervisory Board was established in 1992. The board oversees all matters related to Shariah compliance. The board acts as an appeal authority for disputes between industry and customers in Sudan. Each bank has an internal Shariah board as well. The internal board can be overridden by the High Shariah Supervisory Board.

Products and Services:

Banks in Sudan offer a full range of Islamic financial services. The products are aimed at retail and consumers. Some examples of products offered are:

- Murabahah
- Mudharabah
- Musharakah
- Ijarah
- Salam

Talent Development:

Universities & Institutes in Sudan offering training in Islamic Banking are[22]:

- Cambridge International Training Centre
- Al Oula Institute for Financial & Accounting Studies (Institute)
- Chartered Institute of Management Accountants (Institute)

3.12 Kuwait

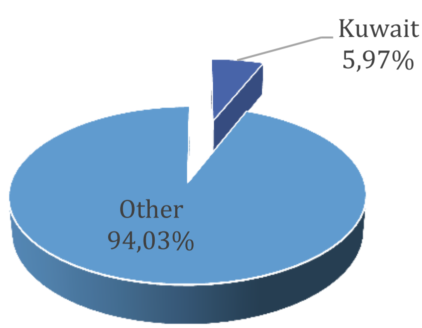
Legal:

Islamic banking institutions in Kuwait are regulated by the Central Bank of Kuwait. The Bank was established in 1968 by the Central Bank of Kuwait Law. The bank regulates the Kuwaiti stock market, the Kuwait Stock Exchange, the Ministry of Commerce and Industry, and the Ministry of Finance.

Regulatory:

In 2010 Law No. 7 established the Kuwait Capital Market Authority. The passage of the law was Kuwait's first comprehensive law for regulating capital markets. Recently provisions to Law No. 22 and other laws are strengthening Kuwait's capital market infrastructure. Other activities by the new Capital Market Authority are still in the nascent stage. Kuwait still has a lot of work to become a developed capital market.

Figure 3.39: Share of Islamic Banking Assets, Kuwait



Source: IFSB 2015

[22] Source: *Simply Sharia Human Capital*, http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/, *All schools listed are Universities unless otherwise denoted.*

Shariah:

The Central Bank of Kuwait does not have a Shariah Advisory Council. Every institution is required to have its own Shariah Supervisory Board per Section 10, Chapter 3, of CBK Law 32/1968. If there is any conflict matters of Shariah can be elevated to the Fatwa Board in the Ministry of Awqaf. The Fatwa Board is independent of the Central Banks, and once elevated to this level the Ministry of Awqaf is the final authority.

Infrastructure:

The infrastructure of Kuwait is still young. The Capital Market Authority is still building regulatory power. The CMA has reached an agreement with the Ministry of Finance clarifying the regulatory responsibilities of each branch. The Central Bank of Kuwait is charged with developing supervision and oversight in the banking industry, enhancing the financial strength of banking units, and modernization of the banking system.

Products and Services:

Kuwait has a wide range of investment products available. They have a diverse set of wholesale and retail products available for use as well. New developments in regulation by both the Capital markets board and the Central Bank should allow for greater development of product and services in Kuwait.

Initiatives:

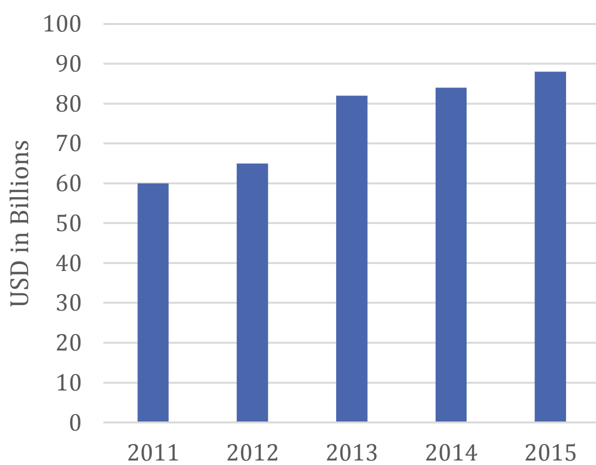
The development of the Capital Markets Board was a major development for Kuwait. The Board continues to roll out new Initiatives to better regulate the capital markets. There are some Islamic Bank specific initiatives such as, branches of foreign Islamic banks are not excluded from placing share for public subscription.

Talent Development:

Universities & Institutes in Kuwait offering training in Islamic Banking are[23]:

- Gulf University for Science & Technology

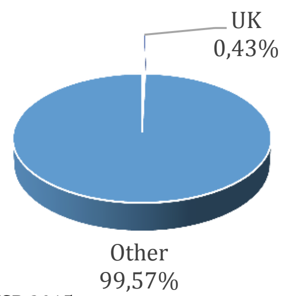
Figure 3.40: Total Banking Assets, Kuwait



[23] Source: *Simply Sharia Human Capital,* *http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/, All schools listed are Universities unless otherwise denoted.*

3.13 United Kingdom

Figure 3.41: Share of Islamic Banking Assets, UK



Source: IFSB 2015

Development of Islamic finance in the United Kingdom is moving fast. The United Kingdom is home to the first wholly Shariah compliant retail bank in the west. London has become one of the most important financial centers in the world.

Legal:

The Financial Services and Market Act of 2000 is key legislation governing Islamic finance in the United Kingdom. Under the Financial Services Act of 2000, Mudharabah Sukuk is unregulated as an investment scheme.

Regulatory:

London has developed a major role in the finance industry. The development of this center has been aided by the open and flexible regulatory environment. This environment accommodates conventional and Islamic banking assets. The Financial Services Authority regulates the financial services industry in the United Kingdom. Any company who wishes to conduct a financial services business must apply to the Financial Services Authority before conducting any regulated activity. The United Kingdom is a member state of the European Union, as such, companies must prepare their financial statements according it IFRS standards.

Shariah:

A Shariah board is not required in the United Kingdom. The Financial Services Authority has no regulation on Shariah or a Shariah governing body. However, it is considered best practice for Islamic banks and financial companies to maintain an internal Shariah board to ensure Shariah compliance.

Infrastructure:

The financial infrastructure is robust and competitive. In 2010, SWIFT, the society for world interbank payments, developed an automated messaging standard to support Murabaha transactions. The London Stock Exchange offers a range of securities such as equities, REITs, and ETFs. The London Stock Exchange also offers Shariah-complaint securities.

Initiatives:

The United Kingdom has a number of Initiatives to develop Islamic finance. Capital gains tax and stamp duty land tax is abolished for Sukuk issuances and Shariah-compliant home mortgages. The Central Bank maintains a HM Treasury Islamic finance experts group. The government continues to strive for clarity when introducing new financial regulatory measures for conventional or Islamic finance.

Talent Development:

Universities & Institutes in the United Kingdom offering training in Islamic Banking are[24]:

- Aston Business School
- BPP University
- Bangor University
- Durham University
- ICMA Centre - Henley Business School
- Institute for Islamic Banking & Insurance
- London School of Business & Finance (LSBF)
- The Markfield Institute of Higher Education (MIHE)
- University of Bolton
- University of Cambridge (Judge Business School)
- University of Dundee
- University of East London
- University of Salford
- University of South Wales
- Chartered Institute of Management Accountants (CIMA) (Institute)
- Chartered Institute for Securities & Investment (CISI) (Institute)

** Sources: All Country Statistics are from: CIA World Factbook: https://www.cia.gov/library/publications/the-world-factbook/geos/uk.html, Islamic Banking Statistics are from Bankscope, E* (State Bank of Pakistan, 2014) *Ernst and Young, or World Bank's Islamic Banking Database, Country Specific Information gathered from respective Central Bank's Global Islamic Finance Report 2015*

[24] Source: *Simply Sharia Human Capital,* http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/, *All schools listed are Universities unless otherwise denoted.*

Chapter 4

4.1 Policy Recommendations

24 Policy Recommendations have been determined through gathering data from several resources as well as conducting the OIC Survey administered to academics, industry members, and regulators in the Islamic Finance industry throughout the world. These recommendations are the components of what is needed in a country's National Islamic Finance Strategy and are expanded in Table 4.1 below. These recommendations serve as a framework for building the Islamic Finance industry and contain a breakdown for ways of bringing on these improvements by specific industry stakeholder categories that consist of governments, Islamic Financial Institutions, central banks, research institutions, non-financial Institutions, and finance industry organizations.

In regards to who will own the strategy in terms of political will, this must be determined by Islamic finance stakeholders within each given OIC member country. This could be determined by either a political leadership or by government/public institutions.

4.1.1 Signals for Measuring Progress

Table 4.2 details the signals that can be assessed for measuring progress on implementing the recommendations stated in Table 4.1. These are consistent with the components in the Islamic Finance Strategy framework. The signals for measuring progress were determined from Islamic Finance Reports, national Islamic Finance Strategies, the survey administered, and the IFSB Mid-Term Review Report.

Table 4.1: Recommendations Table and Signals for Measuring Progress

No.	IFS Component	Task #	Recommendation	Signals for Measuring Progress
1	Regulatory	1.1	Review existing regulations and guidelines to ensure compatibility with Shariah guidelines	• The number of OIC member countries that have reformed guidelines that are Shariah compatible
		1.2	Develop a regulatory agency to monitor secondary markets and exchanges	• The number of OIC member countries that have regulatory agencies
		1.3	Develop a legal infrastructure to foster growth of the Islamic financial system	• The proportion of member countries that have tax neutrality • Number of government agencies that support Islamic finance.
		1.4	Develop a specific disclosure guidelines for Islamic banks that increases transparency	• Level of collaboration with International Industry Standard setting organizations (i.e. Basel Committee) • Islamic Bank Transparency level in comparison to conventional banks

Table 4.1: Recommendations Table and Signals for Measuring Progress cont.				
No.	**IFS Component**	**Task #**	**Recommendation**	**Signals for Measuring Progress**
2	Shariah	2.1	Create an independent National Shariah Board to provide oversight and governance to internal and independent Shariah boards.	• The amount of OIC member countries that have national Shariah standards and/or national Shariah boards • The amount of countries that have adopted international Shariah standards into their governance framework
		2.2	Develop seminar and training programs for Shariah scholars about Islamic banking operations and product development	• The amount of training programs that specialize in Islamic banking operations and product development.
		2.3	Increase collaboration between Shariah scholars and Islamic bank management	• The acceptance rate of Islamic financial products with Shariah Scholars
3	Infrastructure	3.1	Develop secondary markets for Islamic financial products	• The amount of OIC member countries that have developed regulatory infrastructure as well as market infrastructure for IF secondary markets
		3.2	Develop exchanges for Islamic financial products	• The amount of OIC member countries that have developed regulatory infrastructure as well as market infrastructure for IF exchanges
		3.3	Adopt a national Islamic banking accounting standard	• The proportion of OIC members that request adherence to applicable accounting and auditing standards created by Industry Standard setting organizations.
		3.4	Revaluate liquidity management frameworks for national banks	• The overall growth (example: as measured by total assets) of Islamic banks
		3.5	Develop a specific liquidity framework for Islamic banks	• The overall growth and success rate of Islamic banks

Table 4.1: Recommendations Table and Signals for Measuring Progress cont.				
No.	**IFS Component**	**Task #**	**Recommendation**	**Signals for Measuring Progress**
4	Products and Services	4.1	Increase range of Islamic products and services to satisfy the needs and demands of the Islamic finance and Islamic social finance client	• The market share of Islamic banking assets • The market share of Islamic capital markets
		4.2	Encourage innovation and adoption of new technology	• The amount of new technologies adopted in the Islamic finance sector
		4.3	Revaluate tax implementations for Islamic financial services and products	• The number of OIC member countries that have revaluated their tax codes for Islamic financial services and products • Evaluation of tax burdens between Islamic and conventional banks
5	Initiatives	5.1	Develop national campaigns to increase brand awareness of Islamic finance and social finance	• Number of government agencies and initiatives that support Islamic finance brand awareness
		5.2	Create a new campaign to focus on the positives of Islamic finance for non-Muslim investors	• Number of new campaigns that support Islamic finance.
		5.3	Encourage expansion of Islamic social finance in order to promote financial inclusion for the poor.	• The amount of Islamic microfinance institutions based in each member country • The amount of financial coaches that work with the poor • Amount of Islamic social finance institutions that offer mobile banking services • Number of promotions campaigns that inform the poor about the financial services available to them

Table 4.1: Recommendations Table and Signals for Measuring Progress cont.				
No.	**IFS Component**	**Task #**	**Recommendation**	**Signals for Measuring Progress**
6	Talent Development	6.1	Promote and sponsor academic research on Islamic finance and social finance	• Number of Islamic finance research institutions that facilitate research on Islamic finance
		6.2	Increase training and academic programs specific to Islamic finance	• The number of new academic programs with a focus in Islamic finance
		6.3	Develop industry certifications for Islamic finance	• The number of new certification programs with a focus in Islamic finance
		6.4	Create scholarship and grant programs that sponsor individuals who are interested in working in the Islamic finance industry	• The number of new scholarship and grant programs with a focus in Islamic finance
		6.5	Create Islamic finance industry trade associations	• The number of new Islamic finance industry trade associations. • Countries with existing trade associations should continue to see greater influence by industry trade groups.
		6.6	Develop and host conferences for Islamic finance industry members, researchers, and regulators to share ideas and collaborate on ways of growing and improving the industry	• The amount of collaborative projects occurring between Islamic finance industry members, researchers, and regulators

Source: IFSB Mid-Term Review 2014

4.2 Framework for the Implementation of the Recommendations

Implementation of these recommendations is a complex task. This framework serves a guide for stakeholders in implementation. The stakeholders included in this framework are the following:

- Governments
- Islamic Financial Institutions
- Central Banks

- Research Institutions
- Non-financial Institutions
- Finance industry organizations

Table 4.2 lists the suggested stakeholders for implementing the IFS and Recommendations. These stakeholders provide examples of the type of entities that are suitable for the implementation of the stated recommendations. New entities may need to be created in order to pursue some of these recommendations if a suitable entity does not exist in a given country. Some of these listed stakeholders have been included in existing national Islamic Financial Strategies for specific countries, specifically Turkey. Table 4.3 acts as a suggested framework for a country to determine what type of Islamic Finance stakeholder would be most suitable for implementing each recommendation.

Table 4.2: Islamic Finance Strategy Tasks for Stakeholders

No.	IFS Component	Task #	Recommendation	Responsible Organizations & Institutions					
				Governments	Central Banks	Islamic Financial Institutions	Research Institutions	Islamic Non-financial Institutions	Islamic Finance Industry Organizations
1	Regulatory	1.1	Review existing regulations and guidelines to ensure compatibility with Shariah guidelines	X					
		1.2	Develop a regulatory agency to monitor secondary markets and exchanges	X	X				
		1.3	Develop a legal infrastructure to foster growth of the Islamic financial system	X	X				
		1.4	Develop a specific disclosure guidelines for Islamic banks that increases transparency	X	X	X			

Table 4.2: Islamic Finance Strategy Tasks for Stakeholders cont.

No	IFS	Task #	Recommendation	Responsible Organizations & Institutions					
				Governments	Central Banks	Islamic Financial Institutions	Research Institutions	Islamic Non-financial Institutions	Islamic Finance Industry Organizations
2	Shariah	2.1	Create an independent National Shariah Board to provide oversight and governance to internal and independent Shariah boards.	X		X			
		2.2	Develop seminar and training programs for Shariah scholars about Islamic banking operations and product development			X	X	X	X
		2.3	Increase collaboration between Shariah scholars and Islamic bank management			X			X
3	Infrastructure	3.1	Develop secondary markets for Islamic financial products		X				X
		3.2	Develop exchanges for Islamic financial products		X				X
		3.3	Adopt a national Islamic banking accounting standard			X			X
		3.4	Revaluate liquidity management frameworks for national banks		X				
		3.5	Develop a specific liquidity framework for Islamic banks		X				

Table 4.2: Islamic Finance Strategy Tasks for Stakeholders cont.									
No	IFS	Task #	Recommendation	Responsible Organizations & Institutions					
				Governments	Central Banks	Islamic Financial Institutions	Research Institutions	Islamic Non-financial Institutions	Islamic Finance Industry Organizations
4	Products and Services	4.1	Increase range of Islamic products and services to satisfy the needs and demands of the Islamic finance and Islamic social finance client			X			X
		4.2	Encourage innovation and adoption of new technology			X			X
		4.3	Revaluate tax implementations for Islamic financial services and products	X					
		5.1	Develop national campaigns to increase brand awareness of Islamic finance and social finance						X
5	Initiatives	5.2	Create a new campaign to focus on the positives of Islamic finance for non-Muslim investors						X
		5.3	Encourage expansion of Islamic social finance in order to promote financial inclusion for the poor.	X		X		X	

Table 4.2: Islamic Finance Strategy Tasks for Stakeholders cont.										
No	IFS	Task #	Recommendation	Responsible Organizations & Institutions						
				Governments	Central Banks	Islamic Financial Institutions	Research Institutions	Islamic Non-financial Institutions	Islamic Finance Industry Organizations
6	Talent Development	6.1	Promote and sponsor academic research on Islamic finance and social finance	X	X	X	X	X	X
		6.2	Increase training and academic programs specific to Islamic finance	X		X	X	X	X
		6.3	Develop industry certifications for Islamic finance			X	X	X	X
		6.4	Create scholarship and grant programs that sponsor individuals who are interested in working in the Islamic finance industry	X		X	X		
		6.5	Create Islamic finance industry trade associations						X
		6.6	Develop and host conferences for Islamic finance industry members, researchers, and regulators to share ideas and collaborate on ways of growing and improving the industry				X		X

Source: OIC Report Survey and IFSB 2015 Mid-Term Review

4.2.1 Suggested Stakeholders for IFS and Recommendations

Table 4 lists the examples of responsible stakeholder for the implementation of IFS and Recommendations. 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. 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.

Table 4.3: Suggested Stakeholders for IFS and Recommendations[25]

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 Republic of Turkey (CBRT) **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 Real 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

[25] Jung, CD. "Top 500 Financial Islamic Institutions Listing." *The Banker* (n.d.): n. pg. Web. 20 Dec. 2015. <https://ribh.files.wordpress.com/2008/01/top-500-islamic-financial-institutions-the-banker-november-2007.pdf>.

Table 4.3: Suggested Stakeholders for IFS and Recommendations[26] 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 (YÖK), **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

[26] Jung, CD. "Top 500 Financial Islamic Institutions Listing." *The Banker* (n.d.): n. p
g. Web. 20 Dec. 2015. <https://ribh.files.wordpress.com/2008/01/top-500-islamic-financial-institutions-the-banker-november-2007.pdf>.

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 Indonesia, Turkey, Qatar, and Pakistan have developed national Islamic Finance strategies, but the majority of OIC member countries have not.

This OIC report details the six main components needed in order to develop a national Islamic Finance Strategy, what key stakeholders should be responsible for each component, and the time scope for the implementation of Islamic Finance Strategy components.

The main components of the Islamic Finance Strategy framework are:

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

Key recommendations were discussed that stem from the six main IFS components and signals for measuring the progress can be referenced so that governments and IFS stakeholders can assess their implementation status and see what can be done for further improvement, with a breakdown below.

No.	IFS Component	Task #	Recommendation	Responsible Stakeholders
1	Regulatory	1.1	Review existing regulations and guidelines to ensure compatibility with Shariah guidelines	• Governments
		1.2	Develop a regulatory agency to monitor secondary markets and exchanges	• Governments • Central Banks
		1.3	Develop a legal infrastructure to foster growth of the Islamic financial system	• Governments • Central Banks
		1.4	Develop a specific disclosure guidelines for Islamic banks that increases transparency	• Governments • Central Banks • Islamic Financial Institutions

No.	IFS Component	Task #	Recommendation	Responsible Stakeholders
2	Shariah	2.1	Create an independent National Shariah Board to provide oversight and governance to internal and independent Shariah boards.	• Governments • Islamic Financial Institutions
		2.2	Develop seminar and training programs for Shariah scholars about Islamic banking operations and product development	• Islamic Financial Institutions • Research Institutions • Islamic Non-financial Institutions • Islamic Finance Industry Organizations
		2.3	Increase collaboration between Shariah scholars and Islamic bank management	• Islamic Financial Institutions • Islamic Finance Industry Organizations
3	Infrastructure	3.1	Develop secondary markets for Islamic financial products	• Islamic Financial Institutions
		3.2	Develop exchanges for Islamic financial products	• Central Banks • Islamic Finance Industry Organizations
		3.3	Adopt a national Islamic banking accounting standard	• Central Banks • Islamic Finance Industry Organizations
		3.4	Revaluate liquidity management frameworks for national banks	• Central Banks
		3.5	Develop a specific liquidity framework for Islamic banks	• Central Banks
4	Products and Services	4.1	Increase range of Islamic products and services to satisfy the needs and demands of the Islamic finance and Islamic social finance client	• Islamic Financial Institutions • Finance Industry Organizations
		4.2	Encourage innovation and adoption of new technology	• Islamic Financial Institutions • Islamic Finance Industry Organizations
		4.3	Revaluate tax implementations for Islamic financial services and products	• Governments

No.	IFS Component	Task #	Recommendation	Responsible Stakeholders
5	Initiatives	5.1	Develop national campaigns to increase brand awareness of Islamic finance and social finance	• Islamic Finance Industry Organizations
		5.2	Create a new campaign to focus on the positives of Islamic finance for non-Muslim investors	• Islamic Finance Industry Organizations
		5.3	Encourage expansion of Islamic social finance in order to promote financial inclusion for the poor.	• Governments • Islamic Financial Institutions • Islamic Non-financial institutions
6	Talent Development	6.1	Promote and sponsor academic research on Islamic finance and social finance	• Governments • Central Banks • Islamic Financial Institutions • Research Institutions • Islamic Non-financial institutions • Islamic Finance Industry Organizations
		6.2	Increase training and academic programs specific to Islamic finance	• Governments • Islamic Financial Institutions • Research Institutions • Islamic Non-financial institutions • Islamic Finance Industry Organizations
		6.3	Develop industry certifications for Islamic finance	• Research Institutions • Islamic Non-financial institutions • Islamic Finance Industry Organizations
		6.4	Create scholarship and grant programs that sponsor individuals who are interested in working in the Islamic finance industry	• Governments • Islamic Financial Institutions • Research Institutions
		6.5	Create Islamic finance industry trade associations	• Islamic Finance Industry Organizations
		6.6	Develop and host conferences for Islamic finance industry members, researchers, and regulators to share ideas and collaborate on ways of growing and improving the industry	• Research Institutions • Islamic Finance Industry Organizations

The Islamic finance industry has tremendous potential in becoming an integral part of the global finance industry. Notable scholars, such as (Robertson, 1990; 1998), (Vogal & S, 1998) have argued that there is a substantial need for an economy that is interest-free. (Chapra, 1985) & (Mills & Presley, 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.

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.

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.

Salam (1990) has argued that, "Being an Islamic institution with responsible mission, the [Islamic] bank must act with more developmental orientation". 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.

(Hassan & Kayed, 2009) State that, "The principles of Islamic finance advocate fairness in payoffs and reward structures and embrace socio-economic justice amongst all." The growing distrust in the conventional banking sector due to greed and exploitation brings the opportunity for growth in the Islamic Finance sector. 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." 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.

References

(n.d.). In M. K. Hassan, & M. Lewis (Eds.), *Operational Efficiency and preformance of Islamic banks'* (p. Chapter 7).

Al-Suwailem, S., & Hassan, M. K. (n.d.). An Islamic Perspective of Financial Engineering. In *Islamic Financial Engineering .* 2015: Wiley.

Central Bank of Bahrain. (n.d.). *Central Bank of Bahrain*. Retrieved 2015, from http://www.cbb.gov.bh/page-p-Islamic_finance.htm

Chapra, U. (1985). Towards a just Monetary System. *Leicester: The Islamic Foundation*.

Chowdhury, Alam, M., Hassan, M., & Hussain, M. S. (n.d.). Zakat in an Islamic Macro-Economic Model,. In *Zakat and Poverty Alleviation* (p. Chapter 4). Islamic Economics Research Bureau.

CIA. (n.d.). *CIA World Factbook*. Retrieved 2015, from : https://www.cia.gov/library/publications/the-world-factbook/geos/uk.html

Dar, H. (2014). *Global Islamic Finance Report.* Edbiz Consulting.

DAR, H. (2015). *Global Islamic Finance Report.* Edbiz Consulting.

El-Din, T., El-Din, S., & Hassan, M. (n.d.). Islam and speculation in the stock exchange. In *Handbook of Islamic Banking* (p. Chapter 15).

Hassan, A. L. (n.d.). Islamic Capital Markets: Products and Strategies by . In *The Shariah Process in Product Development and Approval in ICM* (p. Chapter 2).

Hassan, M. K., & Dicle, M. F. (2010). Islamic banking regulations in light of Basel II. *American Journal of Islamic Social Sciences*, 74-101.

Hassan, M. K., & Kayed, R. (2002). The Global Financial Crisis and The Islamic Financial Solution. *Thunderbird International Business Review, 53*(5), 2.

Hassan, M. K., & Kayed, R. (2009). The Global Financial Crisis, Risk Management and Social Justice in Islamic Finance. *ISRA International Journal of Islamic Finance*, 33-58.

Hassan, M., & Bashir, A. H. (n.d.). Determinants of Islamic banking profitability. In *Handbook of Islamic Finance.*

Hawary, Grais, & Iqbal. (2004). Regulating islamic financial institutions : The nature of the regulated. *The World Bank*.

IFSB. (2005). *Guiding Principles of Risk Management for Institutions (Other than Insurance Institutions) Offering only Islamic Financial Services.* IFSB.

IFSB. (2011). *Revised Compilation Guide on Prudential and Structural Islamic Financial Indicators.* IFSB.

IFSB. (2012). *Guiding Principles on Liquidity Risk Management for Institutions Offering Islamic Fianancial Servicse.* IFSB.

IFSB. (2012). *Standard on Risk Management for Takāful (Islamic Insurance Undertakings).* IFSB.

IFSB. (2014). *REVISED CAPITAL ADEQUACY STANDARD for Institutions offering Islamic Fianancial Services[Excluding Islamic Insurance Institutions and Islamic collective Investment Schemes].* IFSB.

IFSB. (IFSB). *Guiding Princiiples on Stress Testing for Institutions offering Islamic Fianancial Services.* 2012.

IFSB;IDB;IRTI. (2010). *Islamic Finance Global Financial Stability Report.*

Institute of Islamic Banking and Insurance, Credit Agricole CIB, Investment & Finance, Islamic Finance WIKI. (2003). *International Conference on Islamic Banking: Risk Management, Regulation, and Supervision.* World Bank.

Islamic Bankers Association. (2015). *Global Islamic Finance Report.* London: Edbiz Consulting Limited.

Islamic Financial Services Board. (2015, May). *Islamic Financial Services Industry Stability Report 2015.* Retrieved from www.ifsb.org: http://www.ifsb.org/docs/2015-05-20_IFSB%20Islamic%20Financial%20Services%20Industry%20Stability%20Report%202015_final.pdf

Islamic mutual funds. (n.d.). In M. K. Hassan, & M. Lewis (Eds.), *Handbook of Islamic Banking* (p. Chapter 16).

Meirbrugger, A. (2015, September 16). *http://www.gulf-times.com.* Retrieved from Gulf Times: http://www.gulf-times.com/story/455219/Shariah-finance-in-growing-need-for-Islamic-rating

Mills, P. S., & Presley, J. R. (1999). *Islamic finance: Theory and practice.* Basingstoke: Macmillan Press LTD.

Robertson, J. (1990). *Future wealth: A new economics for the 21.* London: Cassell Publications.

Robertson, J. (1998). *Transforming economic life: A millennial challange.* Devon: Green Books.

Simpy Sharia Human Capital. (n.d.). Retrieved 2015, from http://www.simplyshariahc.com/training-and-education/global-islamic-finance-education/,

Smolo, E., & Hassan, M. K. (2011). Capital Adequacy Requirements for Islamic Financial Institutions. *International Journal of Islamic and Middle Eastern Finance and Management*.

State Bank of Pakistan. (2014). *Strategic Plan, Islamic Banking Industry of Pakistan.*

Thomson Reuters. (20114). *Risk Management in Islamic Financial Instruments.* Nasdaq OMX.

Vogal, F., & S, H. (1998). Islamic law and finance: Religion, risk and return. *The Hague International Law Journal*.

Vogel, F., & Hayes, S. (1998). Islamic Law and Finance; Religion, Risk, and Return. *Journal of Law and Religion*, 475-479.

World Bank. (n.d.). *ISLAMIC BANKING OPPORTUNITIES ACROSS SMALL AND MEDIUM ENTERPRISES IN MENA.* IFC.

Wyman, O. (2009). *The Next Chapter in Isalmic Fiance .* Marsh, Mercer, Kroll, Guy Carpenter, and Oliver Wyman.

Appendix A: OIC Member Report Survey

Breakdown of Survey Respondents

The respondents came from a variety of Islamic finance and non-finance sectors, with the breakdown shown in the table below. There was a variety of specializations, with the majority of respondents having a background in Islamic Banking, with the second largest group having a background in Islamic Capital Markets. Regulation also comprised a notable amount of the respondents with 22 percent of the respondents as well as Islamic Social Finance having 32 percent. From Islamic Social Finance, 63 percent of the respondents specialized in Microfinance, 56 percent in zakah, and 33 percent in awqaf.

Survey Respondents Specialization	
Islamic Banking	63%
Capital Markets	35%
Takaful	9%
Regulation	20%
Islamic Social Finance	35%

Islamic Social Finance Specialization	
Zakah	48%
Awqaf	25%
Microfinance	67%

Area(s) of specialization.		
Answer	**Response**	**%**
Islamic Banking	103	63%
Capital Markets	57	35%
Takaful	15	9%
Regulation	33	20%
Islamic Social Finance	57	35%
Specialization(s) in Islamic Social Finance?		
Answer	**Response**	**%**
Zakah	25	48%
Awqaf	12	25%
Microfinance	34	67%

Microfinance

Is Islamic Microfinance better at tending to the needs of the severely impoverished more than its conventional counterparts?		
Answer	**Response**	**%**
Yes	26	84%
No	5	16%

Does the higher cost of microfinance drives beneficiaries into severe debt?		
Answer	**Response**	**%**
Yes	19	65%
No	11	35%

Should financial co-ops, non-profits and for-profit microfinance institutions be grouped together and subject to the same regulation?		
Answer	**Response**	**%**
Yes	13	50%
No	14	50%

Should "women-only" microfinance be included in Islamic Mfis offerings?		
Answer	**Response**	**%**
Yes	12	48%
No	12	52%

Do you consider volunteerism to be a vital microfinance component?		
Answer	**Response**	**%**
Yes	17	72%
No	7	28%

Do you think for-profit finance and philanthropy should be grouped together in its offerings, as in BMts?		
Answer	**Response**	**%**
Yes	17	75%
No	6	25%

Awqaf

Should there be restriction on waqf that the funds can only be used for immovable assets, such as real estate?		
Answer	**Response**	**%**
Yes	1	14%
No	5	86%

What is the efficiency level of a Mutawalli state agency?		
Answer	**Response**	**%**
Low	3	43%
Medium	1	29%
High	2	29%

Should the government have absolute power in the termination of Mutawalli proposed by the waqif and the waqif should manage the waqf assets?		
Answer	**Response**	**%**
Yes	1	14%
No	5	86%

Are the laws against negligent and dishonest Mutawallis effective?		
Answer	**Response**	**%**
Yes	1	14%
No	5	86%

Zakah

Which institution do you consider to perform better at zakah management?		
Answer	**Response**	**%**
State Institution	10	63%
Private Institution	6	38%

Should zakah payment be required?		
Answer	**Response**	**%**
Yes	17	100%
No	0	0%

Should zakah be considered a deduction for and why:		
Answer	**Response**	**%**
Tax payable	9	50%
Taxable income	3	17%
Other	6	33%
Total	18	100%

Should zakah management be corporatized?		
Answer	**Response**	**%**
Yes	10	56%
No	8	44%

Should zakah allocation for other beneficiary types be performed only after the needs of severely impoverished people are attended to?		
Answer	**Response**	**%**
Yes	13	76%
No	4	24%

What would be the appropriate amount of regulation for the Islamic Social Finance sector?		
Answer	**Response**	**%**
High	9	53%
Medium	7	41%
Low	1	6%

Do you consider strict laws and overregulation to suppress the sector?		
Answer	**Response**	**%**
Yes	7	44%
No	9	56%

Is it necessary to separate zakah funds from other donor funds?		
Answer	**Response**	**%**
Yes	15	100%
No	0	0%

Should there be a percentage cap on zakah fund administrative costs?		
Answer	**Response**	**%**
Yes	12	80%
No	3	20%

What is the level of importance for zakah fund utilization to conform to the givers wishes?		
Answer	**Response**	**%**
High Importance	7	47%
Moderate Importance	4	27%
Low Importance	4	27%

Should zakah funds be used to cover or guarantee against credit default?		
Answer	**Response**	**%**
Yes	4	27%
No	11	73%
Total	15	100%

Islamic Banking

Question	Yes	No	Other	Total Responses
Are there legal and regulatory infrastructures that work for the establishment and operation of Islamic banks and/or Islamic windows?	34	8	2	44
Are there banking regulations in place that are specific for the operation of Islamic banks?	29	11	1	41
Is there legal and regulatory infrastructure in place that advises Shariah compliant financial contracts?	30	13	1	44
Is there regulation in place that governs insolvency and creditor rights for Islamic banking?	29	8	4	41
Are there Deposit Insurance facilities that are for Shariah compliant deposits?	27	12	5	44
Is there tax neutrality for Islamic finance activities?	20	20	3	43
Is there an arbitration and dispute resolution for Islamic finance transactions?	18	20	3	41
Is there regulation that protects consumers?	29	11	2	42
Is there regulation in place that governs cross-border financial transactions?	30	11	2	43
Is there regulation present for SIBs (Systematically Important Banks)?	16	16	7	39
Is there regulation present for CSR (Corporate Social Responsibility)?	25	15	3	43

Question	Yes	No	Other	Total Responses
Are there Shariah standards and guidelines put in place for Islamic financial products and services?	30	11	1	42
Are there accounting standards put in place for the operations of Islamic banking?	23	15	3	41
Are their auditing standards for the operations of Islamic banking?	21	16	3	40
Are there External Credit Assessment Institutions that assess Islamic financial institutions products and services?	19	17	4	40
Are there Central Bank issued liquidity instruments that are Shariah-compliant?	22	17	2	41
Are there interbank money market instruments that are Shariah-compliant?	21	18	1	40
Are there Lender of the Last Resort facilities that are Shariah-compliant?	16	18	6	40
Is there a payment and settlement system in place?	32	6	3	41
Is there a monetary and exchange system in place?	24	11	5	40

Are there guidelines for any of these infrastructures for Islamic banking operations?

Question	Yes	No	Will have in future	Total Responses
Risk Management	32	6	2	40
Capital Adequacy	30	7	3	40
Corporate Governance	32	7	1	40
Transparency	30	8	2	40
Market Discipline	28	9	3	40
Supervisory Review	28	8	4	40
Business Conduct	31	8	1	40
Shariah governance	30	7	3	40

Question	Yes	No	Other	Total Responses	Mean
Is there a monetary and exchange system in place?	31	5	5	41	1.37
Does the Information and Statistical Infrastructure have periodical Islamic banking statistics?	29	10	1	40	1.30
Does the Information and Statistical Infrastructure have macro-prudential indicators for the overall banking and specifically for Islamic finance?	24	12	4	40	1.50
Is there a Center for Research and Development specifically for Islamic banks?	24	14	3	41	1.49
Does your organization award incentives to build an Islamic banking industry?	16	20	3	39	1.65

Does your organization adhere to any of the international standards below? Check the ones that apply.		
Answer	**Response**	**%**
Islamic Financial Services Board	18	49%
Accounting and Auditing Institution for Islamic Financial Institutions	15	42%
Basel Committee for Banking Supervision	21	57%
International Accounting Standard Board	23	62%
Organization for Economic Co-operation and Development	11	30%
The Joint Forum	2	5%
Other (Specify if needed)	5	14%

What are the reasons and challenges that are present regarding the international standards of the Islamic banking sector? Check the ones that apply.		
Answer	**Response**	**%**
There are contradictions with the existing rules and regulations	16	43%
Applying the international standards for Takaful Operations is not a Regulatory and Supervisory Authorities (RSA) priority	12	32%
There is no enforcement present from an international standard setting entity.	22	59%
There is an absence of awareness of international standards.	19	51%
There is inadequate knowledge and understanding on implementing the standards.	20	54%
There is a shortage of supporting infrastructures for implementing the standards.	20	54%

Are structures of Shariah governance for ICM entities present and if so, are they required?				
Question	**Yes, the governance structure is present and required.**	**Yes, the governance structure is present**	**No, this governance structure is not present**	**Total Responses**
National Shariah Board	18	2	16	36
Internal Shariah Board	25	8	3	36
Shariah secretariat	22	4	7	33
Internal Shariah Compliance Unit	23	5	8	36
Internal Shariah Review Unit	22	4	9	35
External Shariah Review / Audit	20	2	13	35

Has your region developed training programs on Islamic banking for institution staff and Islamic banks?		
Answer	**Response**	**%**
Yes	35	88%
No	4	10%
No, but planning to in the future.	1	3%

Has your region developed training programs on Islamic banking for institution staff and Islamic banks?				
Question	**Yes**	**No**	**No, but planning to in the future.**	**Total Responses**
Is there workshop training?	32	3	0	35
Are there seminars being held?	31	2	0	31
Are there conferences being held?	31	2	1	34
Are there transfers to Islamic financial institutions from international organizations, research centers, market intermediaries, etc.)?	21	12	1	34
Are Islamic finance scholarships being issued?	22	8	4	34
Other	2	0	1	3

What is the capacity ICM entities and their staff in your region?				
Question	**High**	**Medium**	**Low**	**Total Responses**
Shariah knowledge	17	8	8	33
Product development	11	12	9	32
Treasury management	10	15	8	33
Liquidity management	12	12	9	33
Risk management	15	13	5	33
Governance and control	15	11	7	33
Accounting and reporting	11	15	7	33

Research and development	10	10	13	33
Marketing	13	13	7	33
Customer Relationship Management	9	19	5	33

How comfortable is your region with supervising Islamic financial institutions in comparison to conventional institutions?		
Answer	**Response**	**%**
Equal	18	49%
Less	14	38%
More	5	14%

How much is Islamic finance prioritized in your region?		
Answer	**Response**	**%**
High	13	35%
Medium	13	35%
Low	11	30%

Capital Markets

Question	Yes	No	Other	Total Responses
Has your region developed a strategic plan for building an Islamic capital market sector?	16	18	3	37
Are there legal and regulatory infrastructures in place that govern Islamic capital market operations?	19	16	2	37
Is there advising available for Islamic capital market products and services with Shariah compliant financial contracts?	22	15	0	37
Is there regulation in place that governs the insolvency of Islamic capital market instruments and creditor rights?	12	22	3	37
Is there tax neutrality present for Islamic capital market products and services?	13	21	3	37
Is there a dispute resolution mechanism or means of arbitration present to resolve issues with Islamic finance transactions?	10	23	3	37
Are there customer protection regulations in place?	23	13	1	37
Are there regulations present that govern cross-border financial transaction?	21	11	4	36

Question	Yes	No	Other	Total Responses
Is there regulations in place that governs Corporate Social Responsibility?	14	19	4	37
Are there guidelines for Islamic capital market operations for Governance for Islamic Collective Investment Schemes (ICIS)?	11	20	5	36

Question	Yes	No	Other	Total Responses
Is there guidance for issuing Sukuk?	20	13	3	36
Is there Shariah governance present?	18	15	3	36
Are there disclosure requirements for Islamic Capital Market instruments?	17	15	3	35
Is there an Islamic Finance Supervisory Review?	19	16	1	36
Is there business conduct regulation present?	24	10	1	35
Is there an infrastructure of Sharī`ah governance present?	13	20	2	35
Are there Sharī`ah standards for Islamic financial products and services?	17	19	0	36
Are there accounting standards for ICM products and services?	14	19	3	36
Are there auditing standards for ICM products and services?	13	19	4	36
Are there external credit assessment institutions that assess ICM products and services?	9	22	4	35

Question	Yes	No	Other	Total Responses
Is there a payment and settlement system for liquidity management?	25	10	1	36
Is there a monetary and exchange system for liquidity management?	23	11	2	36
Is there periodical ICM statistics for Prudential information and Statistical Infrastructure?	11	20	4	35
Is there a Research and Development Center or institution that focuses on the ICM sector?	15	18	2	35

Question	Yes	No	Other	Total Responses
Does your organization have a strategic plan developed for the Islamic Capital Market sector?	12	20	3	35
Does your region incentivize ICM development?	18	13	4	35

What are the reasons and challenges that are present regarding the international standards of the Islamic banking sector? Check the ones that apply.		
Answer	**Response**	**%**
There are contradictions with the existing rules and regulations.	10	30%
Applying the international standards for Takaful Operations is not a Regulatory and Supervisory Authorities (RSA) priority.	9	27%
There is no enforcement present from an international standard setting entity.	15	45%
There is an absence of awareness of international standards.	14	42%
There is inadequate knowledge and understanding on implementing the standards.	17	52%
There is a shortage of supporting infrastructures for implementing the standards.	21	64%

Are structures of Shariah governance for ICM entities present and if so, are they required?				
Question	**Yes, the governance structure is present and required.**	**Yes, the governance structure is present**	**No, this governance structure is not present**	**Total Responses**
External Shariah Review / Audit	9	6	20	35
Internal Shariah Board	16	8	12	36
Internal Shariah Compliance Unit	14	8	13	35
Internal Shariah Review Unit	12	8	16	36
National Shariah Board	15	3	17	35
Shariah secretariat	10	7	17	34

Question	Yes	No	No, but planning to in the future.	Total Responses
Has your region created ICM capital development programs for institution staff and ICM entities?	15	15	6	36
Is there workshop training for institution staff and ICM entities?	21	14	1	36
Are there seminars being held for institution staff and ICM entities?	23	12	1	36
Are there conferences being held for institution staff and ICM entities?	25	9	2	36
Are there transfers to Islamic financial institutions from international organizations, research centers, market intermediaries, etc.)?	15	18	3	36
Are Islamic finance scholarships being issued?	15	17	4	36

What is the capacity ICM entities and their staff in your region?				
Question	**High**	**Medium**	**Low**	**Total Responses**
Shariah knowledge	7	14	12	33
Product development	10	11	12	33
Treasury management	7	13	13	33
Liquidity management	6	15	11	32
Risk management	8	13	12	33
Governance and control	6	16	11	33
Accounting and reporting	7	16	10	33
Research and development	8	12	13	33
Marketing	5	15	13	33
Customer Relationship Management	4	16	13	33

Takaful

Are these infrastructures included in your region's Takaful sector? Check the ones that apply.		
Answer	**Response**	**%**
Strategic plan for developing a Takaful industry sector	2	29%
Initiatives for the establishment and operation of Takaful and ReTakaful	3	43%
Takaful and ReTakaful operations specific regulation	2	29%
Advising for Takaful and ReTakaful Shariah-compliant financial contracts	6	86%
Regulation in place that governs the insolvency of Islamic capital market instruments and creditor rights	2	29%
Dispute resolution mechanism or means of arbitration present to resolve issues with Islamic finance transactions	2	29%
Customer protection regulation	3	43%
Regulations present that govern cross-border financial transaction	1	14%
Regulations that governs Corporate Social Responsibility	4	57%

Are there guidelines specific for Takaful operations? Check the ones that apply.		
Answer	**Response**	**%**
Takaful Operations Governance	3	50%
Takaful Operations Solvency requirement	2	33%
Takaful Operations Risk management	1	17%
Governance on Shariah compliance	5	83%
ICM instruments Disclosure requirements	1	17%
Business Conduct	3	50%
Other (Please specify)	0	0%

Are any these standards and guidelines put in place for Takaful and ReTakaful operations? Check the ones that apply.		
Answer	**Response**	**%**
Shariah Standards	5	100%
Accounting standards	2	40%
Auditing standards	2	40%

Are there External Credit Assessment Institutions that assess Takaful and ReTakaful products and services?		
Answer	**Response**	**%**
Yes	2	29%
No	5	71%
Total	7	100%

Are these Liquidity Management infrastructures established in your region? Check the ones that apply.		
Answer	**Response**	**%**
Payment and Settlement system	5	83%
Monetary and Exchange system	0	0%
Takaful Liquidity Instruments	1	17%

Are there Periodical Takaful statistics in place?		
Answer	**Response**	**%**
Yes	5	63%
No	3	38%

Is there a Research and Development Institution present specifically for ICM sector?		
Answer	**Response**	**%**
Yes	4	50%
No	4	50%

Does your region reference international standards when developing prudential infrastructures for the Takaful sector? If so, please check the ones that apply.		
Answer	**Response**	**%**
Islamic Financial Services Board (IFSB)	2	50%
Accounting and Auditing Institution for Islamic Financial Institutions (AAOIFI)	3	75%
International Association of Insurance Supervisors (IAIS)	1	25%
International Accounting Standard Board (IASB)	2	50%
Organisation for Economic Co-operation and Development (OECD) (Corporate Governance only)	0	0%
The Joint Forum	0	0%
Other (Please specify)	0	0%

How was your region's solvency requirement and minimum capital requirement for Takaful Operators created? Check the response that applies.		
Answer	**Response**	**%**
No Solvency requirement	0	0%
No minimum capital requirement	0	0%
Based on the IFSB Solvency Model	2	67%
Based on the IAIS Solvency Model	1	33%
Based on the European Commission Solvency Model	0	0%
Other (Please specify)	0	0%
Total	3	100%

Select what would hinder applying the international standards for Takaful Operations in your region.		
Answer	**Response**	**%**
There are contradictions with the existing rules and regulations.	2	50%
Applying the international standards for Takaful Operations is not a Regulatory and Supervisory Authorities (RSA) priority.	1	25%
There is no enforcement present from an international standard setting entity.	3	75%
There is an absence of awareness of international standards.	3	75%
There is inadequate knowledge and understanding on implementing the standards.	4	100%
There is a shortage of supporting infrastructures for implementing the standards.	1	25%
Other (Please Specify)	0	0%

What is the structure of Shariah governance for Takaful operators in your region?		
Answer	**Response**	**%**
National Shariah Board	1	20%
Internal Shariah Board	2	40%
Shariah secretariat	2	40%
Internal Shariah Compliance Unit	3	60%
Internal Shariah Review Unit	3	60%
External Shariah Review / Audit	1	20%
Other (Please specify)	1	20%

Are there Islamic Finance and Takaful training programs for institution operations staff in your region?		
Answer	**Response**	**%**
Yes	6	100%
No	0	0%
No, but planning to in the future. Please specify.	0	0%

Are these specific Islamic Finance and Takaful training programs for institution operations staff in your region?			
Question	**Yes**	**No**	**Total Responses**
Is there workshop training?	6	0	6
Are there seminars being held?	6	0	6
Are there conferences being held?	5	0	5
Are there transfers to Islamic financial institutions from international organizations, research centers, market intermediaries, etc.)?	4	2	6
Are Islamic finance scholarships being issued?	2	3	5
Other Training (please specify)	2	0	2

What is your region's current capacity of Takaful operators and staff in the following terms:				
Question	**High**	**Medium**	**Low**	**Total Responses**
Shariah knowledge	2	1	2	5
Product development	1	2	2	5
Treasury management	2	1	2	5
Liquidity management	1	1	2	4
Risk management	1	2	1	4
Governance and control	1	4	0	5
Accounting and reporting	2	3	0	5
Research and development	1	2	2	5
Marketing	1	2	1	4
Customer Relationship Management	1	2	2	5

Regulation

Check if these infrastructures are present. If they are not presently, but are planning to be in the future, please select other.					
Question	**Al Rahnu**	**Microfinance institutions**	**Finance Company**	**Cooperative**	**Other**
Strategic plan and framework for the development of the respective segments	1	5	7	4	6
Act for the establishment and operation of the respective segments	4	6	7	6	6
Regulations specific for the operation of the respective segments	2	5	7	4	6
Guidance for Shariah-compliant financial contracts	5	5	6	4	6
Regulation on Insolvency and creditor right system	4	5	8	4	5
Tax neutrality	3	4	4	1	6
Arbitration and other dispute resolution mechanism for Islamic finance transaction	4	4	8	3	5
Dispute resolution mechanism	3	2	6	2	6
Regulation on customer protection	4	6	8	5	6
Regulation on cross-border financial transactions	1	2	4	2	8
Please check if these infrastructures are present. If they are not presently, but are planning to be in the future, please select other.					
Question	**Al Rahnu**	**Microfinance institutions**	**Finance Company**	**Cooperative**	**Other**
Regulation on Corporate Social Responsibility	1	1	6	0	4

Adequacy of Capital	1	2	6	0	4
Guidance of risk management	1	2	5	0	5
Governance of Shariah compliance	2	0	7	0	4
Requirements for Financial Disclosure	1	1	7	0	4
Business Conduct	1	2	6	0	4
Shariah Standards for Islamic financial products and services	2	0	7	0	4
Accounting standards for Shariah complaints products and services	1	1	6	0	5

Please check if these infrastructures apply to the following organizations:					
Question	**Cooperative**	**Finance Company**	**Al Rahnu**	**Microfinance institutions**	**Other**
Auditing standards for institution operations	0	8	0	0	5
External Credit Assessment Institutions that assess sector operations	1	6	0	0	6
Liquidity Management Payment and settlement system	1	9	0	0	3
Liquidity Management Platform for exchange of liquidity	1	9	0	0	3
Prudential Information Periodical statistics	1	7	1	0	4
Sector-specific Research and Development Centre/Institutions	1	7	0	1	4
Statistical Infrastructure Periodical statistics	0	8	0	0	5

Are capital adequacy and financial product regulations less strict than in comparison to banks?		
Answer	**Response**	**%**
Yes	4	27%
No	11	73%

Does your region reference international standards when developing prudential infrastructures for the Islamic non-banking financial institution and microfinance sector? Check the ones that apply.		
Answer	**Response**	**%**
Islamic Financial Services Board (IFSB)	8	47%
Accounting and Auditing Institution for Islamic Financial Institutions (AAOIFI)	8	47%
Consultative Group to Assist the Poor (CGAP)	3	18%
Basel Committee for Banking Supervision (BCBS)	12	71%
International Association of Securities Commission (IOSCO)	8	47%
International Association of Insurance Supervisors (IAIS)	3	18%
International Accounting Standard Board (IASB)	6	35%
Organization for Economic Co-operation and Development (OECD) (Corporate Governance only)	5	29%
Other (Please specify)	1	6%

Are structures of Shariah governance for Islamic non-banking financial institution and microfinance sector present and if so, are they required?			
Question	**Yes, the governance structure is present and required.**	**Yes, the governance structure is present**	**No, this governance structure is not present**
National Shariah Board	2	1	9
Internal Shariah Board	7	4	2
Shariah secretariat	2	1	8
Internal Shariah Compliance Unit	5	2	5
Internal Shariah Review Unit	5	3	4
External Shariah Review / Audit	2	4	6

Are there Islamic Finance training programs on Islamic non-banking financial institutions and microfinance institutions for institution staff in your region?	
Answer	**Response**
Yes	10
No	5
No, but planning to in the future. (Please Specify)	0

What are the reasons and challenges that are present in applying the international standards for the Islamic non-banking financial institution and microfinance sector?	
Answer	**Response**
There are contradictions with the existing rules and regulations.	1
Applying the international standards for Takaful Operations is not a Regulatory and Supervisory Authorities (RSA) priority.	0
There is no enforcement present from an international standard setting entity.	3
There is an absence of awareness of international standards.	0
There is inadequate knowledge and understanding on implementing the standards.	4
There is a shortage of supporting infrastructures for implementing the standards.	5
Other (Please Specify)	0
Total	13

Are there Islamic Finance training programs on Islamic non-banking financial institutions and microfinance institutions for institution staff in your region?		
Question	**Yes**	**No**
Is there workshop training?	10	0
Are there seminars being held?	9	1
Are there conferences being held?	8	2
Are there transfers to Islamic financial institutions from international organizations, research centers, market intermediaries, etc.)?	5	3
Are Islamic finance scholarships being issued?	5	4
Other (Please Specify)	0	0

What is your region's current capacity of Islamic non-banking financial institutions and microfinance institutions and their staff in the following terms:			
Question	**High**	**Medium**	**Low**
Knowledge of Shariah law	4	3	4
Development of New Services and Products	2	4	5
Management of Liquidity	2	6	3
Management of Risk	3	5	3

What is your region's current capacity of Islamic non-banking financial institutions and microfinance institutions and their staff in the following terms:			
Governance of Respective Institutions	3	5	3
Financial Reporting and Accounting	4	3	5
Product and Service Research and Development	5	1	5
Marketing of Services and Products	3	5	4
Management of Customer Relationships	4	5	3

Appendix B: Risk Analysis Methodology

This section evaluates common measures beginning with a brief description of the risk matrices that are used in analyzing the risk management of conventional and Islamic banks from different geographic regions. Later, a brief discussion is provided on the methodology of sample selection followed by a comparative analysis of risk management for conventional and Islamic banks across geographic regions. Finally, similar comparative analysis of risk management for conventional and Islamic banks is provided for four major Islamic finance markets: Malaysia, Turkey, United Arab Emirates, Kingdom of Saudi Arabia and Bangladesh.

Brief Description of Risk Matrices

Risk matrices evaluated by this report are provided by the BankScope Database. The Measures can be broadly categorized into four major types: a) Asset quality ratios, b) Capital Adequacy ratios, c) Operational efficiency ratios, and d) Liquidity ratios. Many other risk matrices are computed in the process of risk analysis, however, only the major risk matrices are considered in this report. The following discussion is a brief overview of the risk matrices used in this report.

Asset Quality Ratios[27]

- **Loan Loss Res/Gross Loans**: The loan loss reserve over gross loan ratio indicates how much of the total portfolio has been provided for, but not charged off. It is a reserve for losses expressed as percentage of total loans. Given a similar charge-off policy, the higher the ratio, the poorer will be the quality of the loan portfolio.
- **Loan Loss Prov / Net Int Rev**: Loan loss provision over net interest revenue presents the relationship between provisions in the profit and loss account and the interest income over the same period. Ideally, this ratio should be as low as possible. In a well-run bank, if the lending book is higher in risk, this would be reflected by higher interest margins. If the ratio deteriorates, this means that risk is not being properly remunerated by margins.
- **Loan Loss Res / Impaired Loans**: The loan loss reserve over impaired loans (non-performing loans) ratio relates loan loss reserves to non-performing or

[27] All definitions of Asset Quality, Capital, Operations and Liquidity were obtained from the BankScope database

impaired loans. The higher this ratio, the better the bank is and the more comfortable we will feel about the assets quality.

- **NCO / Net Inc Bef Ln Lss Prov**: Net charge-off over net income before loan loss provision ratio is measured similarly to charge-offs, but against income generated in the year. The lower this ratio, the better, other things being equal.

Capital Adequacy Ratios

- **Equity / Tot Assets**: This ratio measures the ability of the bank to withstand losses. A declining trend in this ratio may signal increased risk exposure and possible capital adequacy problems.
- **Equity / Net Loans**: this ratio measures the equity cushion available to absorb losses on the loan book
- **Equity / Liabilities**: This leverage ratio is simply another way of looking at the equity funding of the balance sheet and is another way of looking at capital adequacy.

Operational Efficiency ratios

- **Net Interest Margin**: This ratio is the net interest income expressed as a percentage of earning assets. The higher this ratio, the cheaper the funding or the higher the margin the bank is commanding. Higher margins and profitability are desirable as long as the asset quality is being maintained.
- **Net Int Rev / Avg Assets**[28]: Net Interest Income over average assets indicates that the item is averaged using the net income expressed as a percentage of the total balance sheet
- **Pre-Tax Op Inc / Avg Assets**: This is a measure of the operating performance of the bank before tax and unusual items. This is a good measure of profitability unaffected by one off non trading activities.
- **Return On Avg Assets** (ROAA)
- **Return On Avg Equity** (ROAE)
- **Dividend Pay-Out**: This is a measure of the amount of post-tax profits paid out to shareholders. In general, the higher the ratio the better, but not if it is at the cost of restricting reinvestment in the bank and its ability to grow its business.

Liquidity Ratios

- **Interbank Ratio**: this is money lent to other banks divided by money borrowed from other banks. If this ratio is greater than 100, then it indicates the bank is a net placer, rather than a borrower, of funds in the market place, and is therefore more liquid.
- **Net Loans / Cust & ST Funding**: This loans to deposit ratio is a measure of liquidity, and high values denote lower liquidity.
- **Net Loans / Tot Dep & Bor**: This ratio has deposits and borrowings, with the exception of capital instruments, as its denominator.

[28] The acronym "AVG" stands for the arithmetic mean of the value at the end of year t and t-1

- **Liquid Assets / Tot Dep & Bor**: This ratio is similar to those mentioned above, but looks at the amount of liquid assets available to borrowers as well as depositors.

Sample Selection Criteria

For each geographic region, a sample of conventional banks is selected as the control sample. The conventional banks are selected with similar total asset size of the Islamic banks from each region. Risk matrices are calculated for both the Islamic and conventional banks. The comparative analysis that follows is accompanied by graphical charts that compare both the Islamic and conventional sample. A similar methodology and sample selection criteria are used to analyze bank risk matrices for four important Islamic banking countries. The countries selected are: Malaysia, Turkey, United Arab Emirates, and Kingdom of Saudi Arabia.