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A turbulent year winds to close with hope on the horizon

2017 is drawing to a close, the frenetic activity of the fourth quarter is winding down and the holiday season is upon us once again. This year has been marked by major events and signposted by scandal, but despite the ongoing pressures we have witnessed an industry both resilient and robust, contributing to positive performance across multiple asset classes. The strength and sophistication of the global Islamic finance markets is displayed to impressive effect in the 2017 edition of our industry-renowned Annual Guide, which this year features a comprehensive overview of the industry from its most respected experts and experienced practitioners.

The past year has had its ups and downs, with oil prices staging a slight recovery and interest rates remaining slow, sustaining confidence in emerging markets and supporting investor activity across the Middle East and Asia. The rising budget deficits of oil-producing nations sparked a sovereign surge that turned 2017 into an exceptional year for Sukuk volumes – with the market once again approaching the US$100 billion mark boosted by massive state issuances.

One of the biggest stories in the Sukuk sector was the entry of Saudi Arabia with its giant US$9 billion debut Sukuk in the first quarter, followed by regular and substantial local currency issuances that sparked significant over-subscription and a surge of investor interest towards the Kingdom.

But other sovereigns too have tapped the market, with giant issuances from Oman, Indonesia and Pakistan as well as a third Sukuk from Hong Kong and new entrants from across Africa sparking renewed hope for the continent as it continues on its Islamic finance journey.

The Dana Gas controversy offered a challenge to the industry, and one which continues to rumble as of writing. The question of Shariah compliance is integral to the Islamic debt capital market and the issue went to the heart of investor fears around the stability and security of Islamic structures. However, the decision of the UK courts to uphold the duty of the issuer to the Sukukholders has done much to reassure the market, and the question has contributed to renewed calls for standardization that are echoing ever more loudly around the world.

The GCC sanctions against Qatar were another surprise this year, providing practical challenges and raising geopolitical concerns across the Gulf. However, the country appears to have adapted to a new normal with growth and investment figures stabilizing, and we can but hope that the new year brings reconciliation to the region.

In Asia, Islamic finance continues to develop apace and Malaysia remains at the forefront of innovation. One of the biggest steps forward this year has been the successful issuance of multiple green Sukuk in the country, setting a worldwide example and achieving a new ASEAN-wide framework that could kickstart a ew revolution in socially responsible Sukuk.

Fintech is another area that is taking off in a big way – with advances across the world. Malaysia, Singapore, the UK, Dubai, Abu Dhabi, Bahrain… all of these locations have launched incubators and accelerators to encourage and expand fintech, while IFN itself launched the pioneering new Islamic Fintech Landscape to size the industry. Watch this space for more developments in the new year.

As we move forward into 2018 the future is both uncertain and optimistic, exciting and intimidating. No one can know what the future will bring, but as the performance of the Islamic markets over past 12 months has shown, Shariah compliant finance is flexible, innovative and strong – giving it the capacity to handle whatever the future may bring as long as we remain true to the moral and ethical principles that underpin the industry.

IFN is delighted to once again offer a multitude of material designed to inform, educate and inspire our readers across the world.

Lauren McAughtry
Group Managing Editor

Expected growth of Islamic finance in 2018

Professor Rifaat Ahmed Abdel Karim
Adjunct Research Professor

Good news. The growth of Islamic finance is expected to continue in 2018. Sovereign Sukuk attracted new issuers in 2017 and the old ones continued to issue. The one question which kept nagging many was: is this growth sustainable or was 2017 an exceptional year? It is to be noted that until the third quarter of 2017, the size of issuance has overtaken that of the whole of 2016. Indeed, from the following analysis, the growth in Islamic finance is expected to continue. In addition, news from Malawi, Brazil and the Maldives suggests that Islamic finance is making inroads, which means that Islamic finance is expanding in new countries.

From November 2016 until October 2017, Malaysia ranked number one in the top five deals in the corporate debt capital market with Sukuk issuance of US$6.22 billion or 47.62%. It was followed by four Gulf countries headed by Saudi Arabia (US$3.50 billion or 26.74%), the UAE (US$2.12 billion or 16.26%), Kuwait (US$500 million or 3.83 %) and Qatar (US$497 million or 3.81%). In the same period, the top five general industries were oil and gas (a deal value of US$3.74 billion), utility and energy (a deal value of US$2.30 billion), real estate/property (a deal value of US$1.94 billion), transportation (a deal value of US$1.84 billion) and telecommunications (a deal value of US$1.54 billion).

However, in the same period, the UAE topped the list in Islamic financing in the top five deals with US$6.66 billion or 48.21%. The top five general industries were: finance (US$2.35 billion or a share of 16.98%); transportation (US$2.15 billion or a share of 15.57%); real estate/property (US$2.13 billion or a share of 15.39%); construction/building (US$2.02 billion or a share of 14.62%) and dining and lodging (US$1.45 billion or a share of 10.49%). In the same list, the UAE was followed by Saudi Arabia (US$2.64 billion or 19,09%), Malaysia (US$2.57 billion or 18.58%), Turkey (US$897.97 million or 6.5%) and Qatar (US$508.84 million or 3.68%).

In the period from November 2016 to October 2017 in the Islamic debt capital markets, the total deal value was US$46.60 billion, while the total deal value of syndicated loans for the same period was US$13.82 billion.

In the Islamic corporate debt market, the total deal value was US$14.74 billion, while the corporate total deal value for the same period was US$13.07 billion.

In terms of global sustainable investment assets, an important component of responsible finance assets globally, it rose by 25% during the past two years to US$22.9 trillion. This was supported by a fundamental recognition, namely that environmental, social and governance factors have a material financial impact on business.

One of the largest contributions to Islamic responsible investment assets is the Malaysian Employees Provident Fund, which allocated RM100 billion (US$24.44 billion) to Simpanan Shariah through 2017 (of which RM59 billion (US$14.42 billion) was taken up at the end of 2016). This allocation is expected to be expanded by RM50 billion (US$12.22 billion) in 2018.

The green bond market during 2017 was expected to surpass the US$100 billion mark in new issuance for the first time. A large proportion of new issuance was coming from emerging market

issuers, including China which has prioritized green finance as it deals with the environmental impacts of rapid industrialization.

2017 saw the first green Sukuk, issued by Tadau Energy in Malaysia, which would be followed by another Sukuk issued by solar park developer Quantum Solar Park. Both Sukuk were issued under the Sustainable & Responsible Investment (SRI) Sukuk Framework that was introduced in 2014.

New avenues for Islamic finance in renewable energy are coming following an Islamic tranche of the Mohammed bin Rashid Solar Park project financing; the funding by the Islamic Corporation for the Development of the Private Sector with the European Bank for Reconstruction and Development of a solar project in Egypt and the participation as the lead investor by National Bonds in the recently launched Dubai Green Fund which plans to eventually reach AED100 billion (US$27.22 billion)

Malaysia's Securities Commission (SC), which is leading the Asian Capital Markets Forum, is supporting the regional ASEAN Green Bond Standards. Indeed, the SC is planning to release a SRI Fund Framework, which will explicitly include encouragement for Islamic SRI funds.

The conscious development of Islamic fintech is taking place in Malaysia (with one Islamic crowdfunding company – Ethis Kapital, part of Ethis Ventures (Ethis) – already approved as one of the first six to receive a peer-to-peer crowdfunding license from the SC). Ethis received the license in 2016 but is expected to begin operations in 2017. Ethis has also joined the UN Global Compact, which has been the foundation for many within responsible finance.

Islamic fintech is being encouraged by the Dubai International Financial Center Hive and Dubai Islamic Economy Development Center and separately in Bahrain's Fintech Bay that provides acceleration for fintech, including Islamic fintech. Abu Dhabi Global Markets has developed a regulatory sandbox that is relatively unique within the emerging markets, and views Islamic fintech within an overall 'ethical, responsible and Islamic fintech' approach. It is developing this under an MoU with the Responsible Finance and Investment Foundation.

Flying high – commercial aviation performance and opportunities for Islamic financing

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The golden period for the airline industry of unbroken profitability since the global financial crisis of 2007-09 continued in 2017, albeit at a slightly reduced, but still significant, level with global airlines forecast to achieve operating income and net profits of US$55.7 billion and US$31.4 billion respectively. Furthermore, economic confidence is suggesting a favorable outlook for the industry, at least for the foreseeable future, despite fuel price and passenger yield headwinds and the recent failure of some long-established European airlines.

> “More Islamic banks and institutions are becoming attracted to the airline industry with its recent and sustainable profitability track record, the reliable value retention characteristic of aircraft assets and the favorable economic outlook for an industry that has never stopped growing”

The headline statistics supplied by the International Air Transport Association (IATA) make impressive reading with more than 100,000 flights a day carrying four billion passengers and 58 million metric tonnes of freight per year on nearly 30,000 aircraft, connecting 20,000 unique city pairs. The industry generates annual gross revenues of nearly US$800 billion and accounts for fully 1% of global GDP spending.

Of major interest to the Islamic financing community is the industry's capital-intensive nature given the means of service provision, the aircraft, are very expensive to acquire with unit purchase prices that can be more than US$200 million for a new technology twin-aisle or wide-body aircraft type. The manufacturing sector for passenger aircraft over 100 seats is dominated by the US-based Boeing Company (Boeing) and European Airbus Group (Airbus) which have a relatively equal market share. Between them, Boeing and Airbus currently deliver approximately 1,500 new aircraft per year with a net cost to airlines estimated at US$125 billion. In the twin-aisle sector, which has tended to be the aircraft category of choice for the Ijarah structure, Boeing has been the major supplier to the market with its B777 and B787 products but Airbus is looking to catch up as the production of its new technology A330neo and A350 starts to build.

Review of 2017

The current year has been a highly productive one for the industry with year-on-year revenue-passenger-kilometer (RPK) traffic demand growth for the first half of the year at 7.9% which has surprised market analysts in being significantly above the long-run (five-year) 6.5% average rate and is actually the strongest growth rate in 12 years. The consequence has been record-high passenger load factors industry-wide of 81.7% with seasonal peaks of 84.5% and an easing of the downward pressure on passenger yields (air fares). The air freight market has also improved with the first half 2017 growth performance of 10.4% being the strongest in seven years and the prospect of a sustained recovery for this sector which has been poorly performing for an extended period.

However, there is still quite a wide disparity in the regional performance of the airline industry and the Middle East has been slowing its rate of growth over the past couple of years from a world leader to a measured performer more usually associated with mature markets in Europe and North America. This is partly due to overcapacity at Middle Eastern carriers which has been caused by a fall in oil prices impacting regional economies and additionally from geopolitical and strategic challenges affecting passenger demand in the region. With the Gulf carriers having a major proportion of the twin-aisle order backlog, there may be some pressure to defer new aircraft deliveries which could reduce demand for Islamic financing in the short term from those airlines that have been significant users to date, particularly from the UAE.

Preview of 2018

There is confidence that airline profitability could improve in 2018, despite oil prices creeping up as current data supports a positive growth outlook for the world's economy. Additionally, surveys conducted by IATA among airline CFOs show more than three-quarters of respondents reporting better results in the second quarter of 2017 versus the prior year period with the trend expected to continue in 2018. The suggestion is that the squeeze on profits seen in the first quarter of 2017 could well have been the inflection point at which profitability now starts to rise again and this could herald a very strong performance in 2018. A cautionary note must be sounded for the movement in fuel prices and the weakness in certain regions which will mean increased profitability will not be evenly distributed.

In terms of the financing requirement and the involvement of Islamic products in the financing mix, 2018 will see more new technology aircraft types entering service and the ongoing switch in production to newer models from previous aircraft generations, particularly with the most popular single-aisle aircraft variants. In order to try and reduce their multiyear order backlogs, Boeing and Airbus are increasing production rates which could potentially result in some overcapacity if the price of fuel remains low and there is reduced economic incentive to retire ageing aircraft. Nonetheless, another 1,600 Boeing and Airbus aircraft will be delivered in 2018 at a purchase price of almost US$130 billion of which approximately three-quarters of the total will need some form of external financing.

Conclusion

The airline industry has a voracious appetite for financing and is constantly exploring all avenues that can provide the cash resources needed for airlines and lessors to purchase and operate the newest and most fuel-efficient technology. While some traditional sources of aircraft financing, particularly European aviation banks, are coming under regulatory and liquidity pressures, more Islamic banks and institutions are becoming attracted to the airline industry with its recent and sustainable profitability track record, the reliable value retention characteristic of aircraft assets and the favorable economic outlook for an industry that has never stopped growing.

Commodities trading and Islamic finance: A year of volatility, stability and change

Sanjeev Dutta *is the executive director of commodities at the Dubai Multi Commodities Center. He can be contacted at sanjeev.dutta@dmcc.ae.*

What a difference a year can make. The first half of 2017 has seen encouraging developments on the commodities front with a recovery in the price of most metals, as well as oil and gas. The Islamic finance industry has shown a robust growth and increasing sophistication and continues to play a pivotal role in the wider global economy.

It has also been a busy time for the Dubai Multi Commodities Center (DMCC) with strong activity across all platforms, not least within the fast-growing commodity finance sector, both conventional and Shariah compliant, which is a growth priority for DMCC going forward.

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Review of 2017

The World Gold Council (WGC)'s August report stated that global gold demand was down 14% in the first six months of 2017 at 2,004t as exchange-traded fund buying softened. On the other hand, bar and coin investment grew, as did both jewellery and technology demand. The WGC said there had been good growth in India and US jewellery had bounced back.

The World Bank Commodities Outlook published in April forecasted that the oil price would average US$55/barrel (bbl) in 2017, against US$46/bbl in 2016, as a result of OPEC and non-OPEC production cuts. Natural gas prices were projected to rise 15% in 2017, led by a 20% jump in US gas prices on strong domestic demand and rising exports. Prices of metals are predicted to increase by an average of 16% in 2017 (after falling nearly 7% in 2016).

On the Islamic finance industry, there have been many positive developments such as rising profitability across the sector and new product introductions. The sector continues to be dominated by Malaysia, the UAE and Bahrain which have set up leading ecosystems to ensure that the industry thrives.

As with any industry, there are challenges, a lack of awareness being one for the Islamic finance sector, which results in a low penetration level of Islamic banking, in particular in the GCC. Despite this, the GCC remains the regional leaders in the Islamic finance sector.

Moreover, recent reports showed that other countries are waking up to the potential of Islamic finance, with Pakistan and Sri Lanka making a concerted effort to develop Islamic finance capabilities, and African nations undertaking similar initiatives.

According to Thomson Reuters, total Islamic finance assets are expected to reach US$3.5 trillion by 2021, with Islamic banking responsible for most of this growth.

In Dubai, FIMBank, a global provider of trade finance, factoring and forfaiting solutions, joined the DMCC's Tradeflow platform. A specialized, interactive ownership registry, with over 180 members, DMCC Tradeflow facilitates efficient, transparent transactions by providing a fully secure online platform for registering possession and ownership of commodities stored in UAE-based facilities.

In its capacity as an introducer, the Tradeflow platform allows the market to access collateral financing in the form of inventory financing, commodity Murabahah and transactions based on Salam contracts. Over the last five years, DMCC Tradeflow transaction values, both Islamic and non-Islamic, have grown significantly with total trades in 2016 alone reaching a value of US$15.8 billion, a value increase of 405% compared with 2015.

Preview of 2018

The World Bank Commodities Outlook in April forecasts that the oil price would increase to US$60/bbl in 2018 as the market regains some stability. Average prices of all precious metal prices, including silver and platinum, as well as gold, are predicted to decline a further 1% in 2018 as benchmark interest rates rise and safe-haven buying ebbs, said the World Bank.

On the Islamic finance industry, S&P Global Ratings believes that the Islamic finance industry will continue to expand but at a slower rate in the coming year.

Conclusion

A World Bank report published on the 17th July 2017 titled 'The Growing Role of Minerals and Metals for a Low-Carbon Future' stated that one of the most significant 'green' developments is electricity storage batteries of all sizes for both automotive and domestic scale use. Demand for relevant metals — aluminium, cobalt, iron, lead, lithium, manganese and nickel — could grow substantially as countries take the actions needed to limit the rise in global temperatures to 2°C, as recommended by the UN.

The Islamic finance industry has expanded at a rapid pace over the last 20 years. There has been significant advancement in products that satisfy Shariah requirements. We believe this trend will continue but at a slower pace.

Dubai is ideally placed as a trading hub that links the east and west, with modern and sophisticated infrastructure, platforms and services and modern and Shariah compliant finance to facilitate transactions between enterprises across every continent. We look forward to playing a pivotal role as firms capitalize on the huge opportunities and exciting changes that lie ahead.

Debt capital markets in Islamic finance grow steadily with cautious outlook

Imran Mufti *is a partner at Hogan Lovells (Middle East). He can be reached at Imran.Mufti@hoganlovells.com.*

Overall growth in the Islamic finance industry can be seen with an increase of 20% from 2016. Global Sukuk issuances have risen to the highest levels in the past five years. However, we are still waiting for the anticipated spike in Islamic banking — an industry with untapped potential given the 1.8 billion Muslims in the world.

Review of 2017

In Asia, the Malaysian market was particularly active. Tadau Energy launched the world's first green Sukuk to fund environmentally sustainable infrastructure projects. More recently, Quantum Solar Park issued the world's largest green Sukuk worth US$235.84 million. Islamic banking assets represent a quarter of the country's total banking assets, with Sukuk issuances outpacing conventional bond sales. The transactions should act as a catalyst for further green Sukuk issuances. Indonesia continued its activity in the Sukuk market, raising US$2.5 billion from a dual tranche earlier in the year – the highest amount the country has ever raised. Indonesia also conducted heavily-oversubscribed Sukuk auctions, reaffirming its commitment to Islamic financing. Similarly, Kuwait's maiden Sukuk issuance was five times oversubscribed.

The GCC countries showed a greater enthusiasm for Islamic finance this year, contributing 80% of US dollar-denominated new issuances. Saudi Arabia launched its debut international Sukuk and first local bond sale and Saudi Aramco, the world's largest oil company, issued its maiden Sukuk. The Kingdom intends to account for 25% of global Shariah compliant assets over the next decade, underpinned by an issuance program of US$120 billion over the next three years. On the regulatory front, Moody's Investors Service has been given the green light to start carrying out credit ratings in Saudi Arabia. The Kingdom is well positioned to tap into the debt capital market and increase confidence for issuers looking to the Sukuk markets to raise capital.

Elsewhere, Jordan returned to the market raising US$105.78 million, demonstrating a burgeoning Islamic finance industry since the passing of the Islamic Finance Sukuk Law in 2012. Qatar also returned to the public debt capital markets after its last issuance in 2015, with a five-year Sukuk issuance. There are encouraging signs that Islamic finance will grow in Iran, with talk of an international offering and potential listing on an international stock exchange. The government of Iran recently issued two Sukuk Ijarah facilities worth a collective US$1.06 billion; and their largest automobile manufacturer floated Sukuk papers worth US$211.09 million — the largest volume of Islamic bonds issued by one entity in the Iranian capital market.

In West Africa, Gambia continued to maintain a strong presence in the Sukuk market. In September, as expected, Nigeria issued its inaugural NGN100 billion (US$276.95 million) Sukuk, attracting lots of interest from investors and practitioners alike.

The Dana Gas saga has been a key case in 2017, as the company argued its US$700 million Sukuk facility was not Shariah compliant. Investors and practitioners will monitor this case as the verdict will ripple into the Islamic market, and likely prompt further discussions around the standardization of financing structures and Shariah compliance standards.

Preview of 2018

Some commentators predict the Islamic finance industry will lose some momentum in 2018, primarily due to downcast economic performances in Islamic countries, as a result of low oil prices. Predictions for 2018 include less certainty and fewer large issuances. Nevertheless, there are a number of Islamic finance transactions on the horizon. It is anticipated that Morocco will issue its first sovereign Sukuk after reportedly missing a 15th September 2017 deadline. Similarly, we can expect Tunisia and Kuwait to emerge as new players, with the latter currently working on a law enabling it to tap into Islamic sovereign debt capital markets. Kenya, East Africa's biggest economy, is also exploring ways to access the Islamic finance market and become a regional hub for Islamic finance products — although it announced amendments to financial services regulations, the country is yet to debut its sovereign Sukuk under existing laws.

There is growing interest in fintech companies, which seek to tap into the digitalized Islamic finance space. Earlier in the year, Yielders became the first London-based Islamic finance start-up to be authorized by the UK's Financial Conduct Authority. Fintech has also developed in the UAE, with Dubai and Abu Dhabi launching their inaugural fintech accelerator programs. Finally, AAOIFI's drafts of its new governance standards for centralized Shariah boards may point to greater progress in 2018.

Conclusion

The Islamic finance markets experienced an uptick in 2017, with a number of large Sukuk issuances. However, there may be a slowdown in 2018. Although practitioners may welcome further regulation that facilitate cross-border transactions and greater standardization, the aforementioned deals point to continued interest in, and the buoyancy of, the Islamic capital markets.

Islamic finance education: A global outlook

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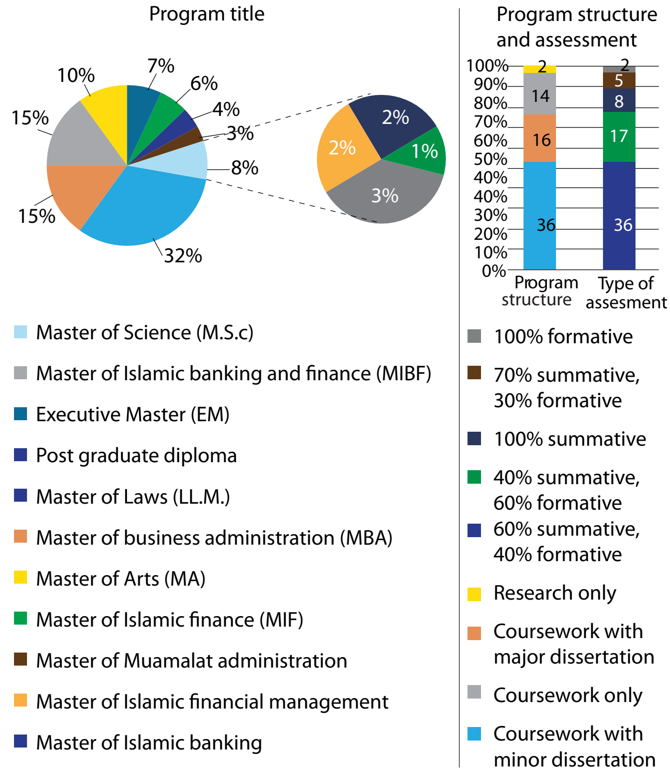
The growth of the Islamic finance industry significantly requires talented people, especially in countries such as Russia, Kazakhstan, Tajikistan, Algeria, Tunisia and Morocco where Islamic finance is a comparatively new phenomenon with significant government support. To have continuous success, such developments should be supported by an adequate number of talents and experts in the field. This has led to growing number of new universities and institutions offering Islamic finance courses along with centers established solely to promote Islamic finance.

The Malaysian Islamic Finance and Economics Report 2016 suggests that the main challenge of the Islamic finance industry nowadays is the the lack of competent human resources. On the other hand, there are more than 533 institutions worldwide offering degrees and courses in Islamic finance.

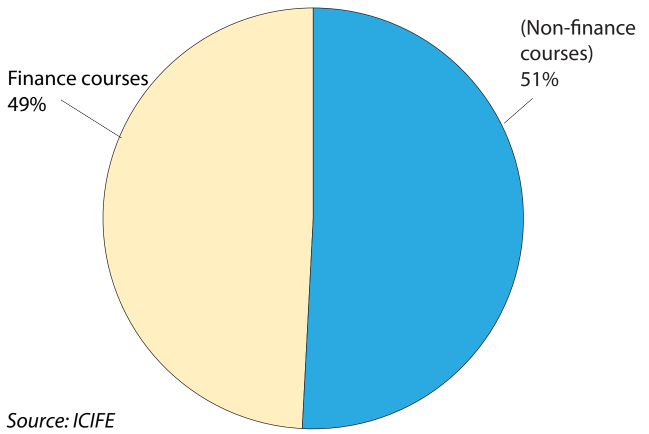
Chart 1: Master programs nomenclature, program structure and assessment



Source: ICIFE

> 51% of the courses offered fall under the non-finance subdomain. Quantitative or information technology leads the non-finance courses by 19%. This can be justified with the emergence of fintech as a future of the global finance. The IT domain is followed by marketing/ management, Islamic economics and Shariah and legal domains which are given approximately the same importance in Islamic finance education

Chart 2: Non-finance and finance subsector domains



Source: ICIFE

Review of 2017

In 2016, the International Council of Islamic Finance Educators (ICIFE) conducted a survey of 40 institutions with 63 Islamic finance Master's programs across 19 countries. The results of the survey showed that the UK has highest number of programs (exceeding 20), followed by Pakistan and Malaysia with fewer than 10. About 32% of universities offer a Master of Science program followed by 15% offering an MBA and professional certification. Program coursework with minor dissertation is highest at 53% of the offered programs.

Within the Islamic finance discipline, both the finance and non-finance courses were examined. Approximately 51% of the courses offered fall under the non-finance subdomain. Quantitative or information technology leads the non-finance courses by 19%. This can be justified with the emergence of fintech as a future of the global finance. The IT domain is followed by marketing/ management, Islamic economics and Shariah and legal domains which are given approximately the same importance in Islamic finance education. On specialization relating to subsectors, it was observed that capital market ranked the highest at 22% followed by banking at 21%. There were significant generic programs (not specified as specialization) that constituted 38% of the sample. The focus on specialization has yet to be more pronounced to facilitate comparison across program types.

Nomenclature

In terms of program nomenclature, as mentioned earlier, 32% of the universities offer a Master of Science program specializing in Islamic finance, Islamic banking or Islamic investments followed by 15%

offering an MBA and professional certification. This presents an interesting indication that both graduate schools and learners prefer either the academic research route, the MBA route or professional certification route in preparing for middle and senior management in Islamic financial or related institutions. With regards to the program structure, coursework with minor dissertation ranked the highest at 53% followed by 23% coursework that appeals to the executive/graduate Islamic finance learning communities. Course assessment for the taught programs ranked highest at 53% with 60% summative (exam) and 40% formative (assignments) followed by 25% with a preference for 40% summative (exam) and 60% formative (assignments).

Developments
The continuous success of the Islamic finance industry requires a sound and established education system. In 2017, this phenomenon was a main topic of international conferences and symposiums. For example, during the 5th Islamic Economics and Finance Education Symposium organized by the Kuala Lumpur-based ICIFE in collaboration with the Jeddah-based Islamic Research and Training Institute (IRTI) in Kuala Lumpur, 50 academicians and industry experts from 15 countries discussed topics such as current developments of the Islamic finance education landscape with reference to learning communities, teaching resources and the academic curriculum for the various academic and professional programs.

> Efforts for the standardization of the Islamic finance education curriculum must be continued through certification and accreditation by an Islamic finance body

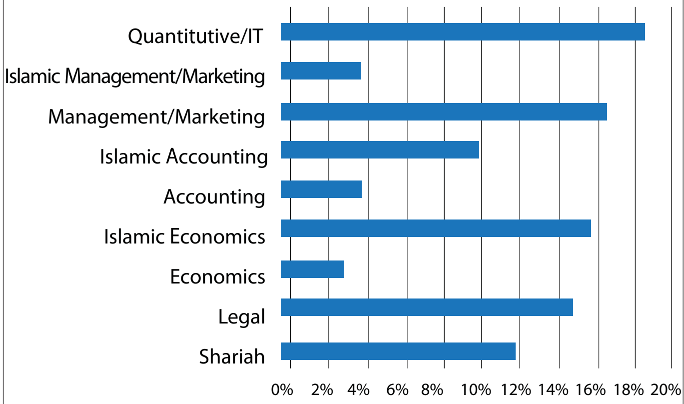
In Istanbul, Istanbul Sabahattin Zaim University (IZU) organized an international congress on Islamic economics and finance and the importance of organizing Islamic finance education conferences was the theme of the keynote address given by Prof Sabri Orman, a board member of the Central Bank of the Republic of Turkey. For the first time, two universities in Turkey, namely KTO Karatay University and IZU, introduced Bachelor's and Master's programs in Islamic finance in English. Another country with spectacular progress in Islamic finance is Kazakhstan. The recently founded Astana International Financial Center (AIFC) established the AIFC Bureau for Continuing Professional Development to address Islamic finance qualifications and training programs. All in all, Islamic finance education has gained momentum in the international arena and this leads to the importance of harmonization and standardization of the curriculum framework.

Preview of 2018

Challenges and the way forward
The main problems Islamic finance programs are facing currently are related to human resources, research quality, methodology, program diversity and industry involvement.

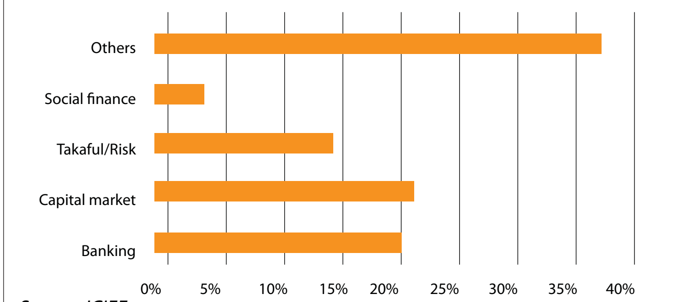
Those problems can be solved with the implementation of three major recommendations:
1. Standardization of education practices
2. Collaboration between western and Muslim institutions, and

Chart 3: Non-finance courses in Islamic finance programs



Source: ICIFE

Chart 4: Finance courses in Islamic finance programs



Source: ICIFE

3. Government support for fundamental and applied research programs relating to alternative finance.

Enhancing Islamic finance education
Islamic finance education can be enhanced by having the following:
1. An international coordination body
2. Improvement in research quality
3. Technical and financial assistance from IRTI
4. Curriculum enhancement and talent development (the ICIFE model)
5. Multi and interdisciplinary skill development, and
6. Communication between the industry and academia.

Conclusion

Conferences in the field of Islamic finance education are important for the continuation of the field's growth. In order to follow on the progress made, clarifying the underlying methodology is needed and also improving coordination and communication between Islamic finance education institutions, so that the Islamic finance education curriculum will reflect the industry's needs and as such include various fields.

Islamic finance scholars must therefore develop expertise in a variety of fields including conventional finance, Shariah law and Islamic economics. Research must be produced by the collaboration of young scholars and professors in both Muslim and non-Muslim countries. Efforts for the standardization of the Islamic finance education curriculum must be continued through certification and accreditation by an Islamic finance body.

These aspects of educational reforms will reduce the gap between theoretical and practical Islamic finance. Islamic finance education is a great tool for future generations in order to deal with the many social, religious, racial and economic conflicts.

IPOs on the up

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There is no doubt that global equity capital markets have rebounded in 2017 and it could be a bumper year for IPOs compared with 2016, especially for Shariah compliant investors. The facts speak for themselves (by the end of the third quarter of 2017, there were more IPOs (over 1,150) than the full year total for 2016) and the word on the street talks optimistically about the world's largest-ever IPO to come in 2018 (notably sourced from an Islamic country). Facts and sentiment seem to have aligned.

Review of 2017

Despite major geopolitical developments including a new administration in the US, elections in Germany and France among others, Brexit developments and increasing tension in the region surrounding North Korea and surprisingly, in GCC countries, and coupled with a stubborn oil price (which has had a particular impact on Shariah compliant investors), protectionism and the easing of central bank policy and increasing interest rates, 2017 proved much better than 2016 for IPOs worldwide, both in terms of the number of IPOs and proceeds.

The bull market continued for both conventional and Shariah compliant investors and we have witnessed in 2017 continued record highs in the Dow Jones Industrial Average, the S&P 500 and the NASDAQ Composite indices and a remarkable performance of the Ghana Stock Exchange Composite Index versus the MSCI World Index. The key features of the global IPO market in 2017 were: (i) a return of the mega deals such as Landis+Gyr Holding on the SIX Swiss Stock Exchange (US$2.4 billion raised), NetLink NBN trust on the Singapore Stock Exchange (US$1.7 billion raised) and ZhongAn Online P&C Insurance Co on the Hong Kong Stock Exchange (US$1.5 billion raised), and (ii) a domination by Asia Pacific in terms of the number of deals and proceeds.

Industrials, technology and consumer products were the most active industry sectors for IPOs in 2017, the former two sectors being particularly attractive to Shariah compliant investors. The financial conditions have been favorable and it was interesting to see financial services regulators being more flexible in order to make the regulatory conditions easier for potential issuers to come to market. For example, the Financial Conduct Authority in the UK is looking to amend its listing rules with a proposal to create a new premium listing category for sovereign-controlled companies. Cynics could argue that this is blatant encouragement for Aramco to choose London as its listing venue but it is also a recognition of who the bigger ticket potential issuers could be in the future.

Another feature, particularly in emerging markets, is the encouragement of SMEs to look to equity capital markets for capital-raising, and start-ups are using disruptive methods such as initial coin offerings. A good example of this is the launch of the Nomu Parallel Market by the Saudi stock exchange, Tadawul, in February 2017 which is a new market in Saudi Arabia with lighter regulatory requirements for issuers wishing to come to market. Investors are limited to qualified investors and there are transitional provisions to encourage issuers to move up to the main market of Tadawul.

The vast majority of Middle East IPOs year to date have been on the Nomu Parallel Market, being an excellent source of potentially Shariah compliant IPOs. Across the board, there has been a significant increase in Middle East IPOs compared with 2016 which can only be good news for Islamic investors as issuers in the Middle East will tend to be Shariah compliant. Another important development is the inclusion of China A stocks in the MSCI Emerging Markets Index effective June 2018 and the inclusion of the MSCI Saudi Arabia Index in MSCI's 2018 Annual Market Reclassification Review for a potential inclusion in the MSCI Emerging Markets Index. Enhanced MSCI classification of Islamic countries will provide Shariah compliant investors with increased investment opportunities. Overall, it was a buoyant IPO story for 2017.

Preview of 2018

One word: Aramco. This is potentially the mother of IPOs and is the one the world is watching. It is fascinating that the Middle East is where considerable capital-raising has been happening, providing a wealth of investment opportunities for Shariah compliant investors. The region has recently been the focus of sovereign debt capital-raising, for example, the record-breaking US$17.5 billion Saudi sovereign bond in October 2016 (edging out Argentina which raised US$16.5 billion of sovereign debt in April 2016) followed shortly by a US$9 billion issuance of Saudi sovereign Sukuk in April 2017 which provided an excellent investment opportunity for Shariah compliant investors who were unable to invest in the 2016 conventional debt issuance.

> "Emerging markets are likely to be a source of international equity investment in 2018 especially as regulators and exchanges are opening themselves up to foreign ownership"

2018 will see the switch to equity with the Aramco offering seeking to raise approximately US$100 billion. Such a large IPO can only have a global impact especially as there could be multiple listings (currently it seems to be a tussle between the London Stock Exchange and the New York Stock Exchange but could it be both and could it even include an Asian exchange given their strong performance in 2017?). It will be interesting to see if a Fatwa in favor of the Shariah compliance of the potential investment will be publicized.

Also, will such a large issuance boost the equity capital markets further or will it cause restraint where potential issuers wait to see what happens in fear of material liquidity being sucked out of the markets and potential investors keep their powder dry for the 'big one'?. Further, the emerging markets are likely to be a source of international equity investment in 2018 especially as regulators and exchanges are opening themselves up to foreign ownership (the Saudi Capital Market Authority and Tadawul being the shining examples with the introduction of a qualified foreign investor regime). We also await the potential inclusion of the MSCI Saudi Arabia Index in the MSCI Emerging Markets Index.

Conclusion

It has been a good year thus far for global equity capital markets for conventional and Shariah compliant investors alike despite geopolitical and economic turbulence. All the boats seem to be rising and look set to do so further in 2018. Potential hikes in interest rates, central bank policy and regulatory easing may also have a positive impact for global equity capital markets leading to more IPOs and further opportunities for Shariah compliant investors.

Islamic banking in the fourth industrial revolution

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The 47th World Economic Forum annual meeting has cast a spotlight on the large impact of rapid developments in technology on the banking sector amid the fourth industrial revolution. The latter has seen the emergence of powerful technologies and trends with the potential to disrupt the world over. The sudden outburst of new technologies has brought about many changes to the way traditional banking has always operated. One main change is the rise of branchless banking services. It brings forward completely new propositions encompassing not only new and improved services, but also serves a more technologically-savvy customer base – one that is very much dependent on using the internet and mobile technology.

Millennials, unlike any generation before, have little or no desire for physical branches to provide them with banking services. They demand direct access and immediate response to their needs without having to walk into a branch. They are an age group that relies on mobile wallets and social media platforms to conduct their banking transactions without compromising on privacy and security, and thus producing a digital footprint in banking services.

Through digitization, banking is now provided at the customer's doorstep. These services include access to financials, instant view of transactions and statement of account, payments, transfer of funds, handling end-to-end loan life cycles, and many more.

Digitization not only helps banks delight their customers and achieve higher customer retention, but it is also helping in reducing costs, hence pushing the growth further.

This new way of banking epitomizes customer outreach based on convenience and relationship-building powered by technology, and banks worldwide are responding by strengthening their internet and mobile platform offerings to offer digital-only banking services to meet the differentiated needs of their customers.

> "In tomorrow's clever banking, taking advice on a Shariah compliant investment from a machine is just the beginning in the relentless march of technology disruption"

Adapting to change is imperative to ensure relevance

Digital banking is all the rage with a growing number of banks striving to make their products and services accessible via different devices and available on different platforms.

Research shows that there is not much of a difference between the preferences of Muslims and non-Muslims regarding digital banking services. But the Islamic banking sector has been lagging behind in adopting deep and transformative digitization strategies compared to its conventional counterpart. For many Islamic banks, this is considered rather revolutionary, as in the past branches had been the first and predominant point of contact with customers.

According to the World Islamic Banking Competitiveness Report 2016 by EY, Islamic banks have a much lower customer penetration in digital services compared to conventional banks. Although the industry is quite young, some Islamic banks are expanding their digital offerings quite quickly; however, most of these banks are still a long way from becoming truly digital as currently, many of them only offer some basic online services.

Their digitization efforts need to catch up fast. Like their conventional peers, Islamic banks too have no choice but to embrace the next-generation of technologies and transform the way they do business to attract tech-savvy customers. Ultimately, for Islamic banking, the use of technology is no longer an option, it is a necessity. To create the best digital footprint, the Islamic banking industry must begin to look outside the box.

Technology is a great enabler

According to recent World Bank statistics, more than two billion people around the world are still unbanked, and about half of them are in the Muslim world. Technology is the answer to more inclusive banking, as the new generation of technologies break down all physical barriers.

While high costs have kept away Islamic banks from serving the unbanked populations, with the arrival of low-cost mobile and internet technologies, it is easier for Islamic banks to serve a greater number of customers in remote areas, and offer digital banking services to ever-larger populations in the Muslim world.

Technology plays a large role in enhancing financial inclusion. It makes banking cheap, simple, compliant, fast, secure, available anywhere and at all hours, so as to reach the majority of people in various regions in a consistent manner. The perception that digital adoption still mostly comprises educated, affluent and urban people is no longer correct.

Given the global ubiquity of digital channels, it is advantageous for Islamic banks to leverage on technology to differentiate themselves by developing their own propositions, enhancing customer reach and providing a seamless and hassle-free banking experience.

Islamic banks in the digital era

The Islamic banking industry has developed rapidly over the last few years, with Islamic banks proliferating in number and in geographic reach. While this success should be lauded, it should not lull Islamic banks into contentment, as the continued growth of the industry will depend in part on innovations and customer satisfaction.

Therefore, Islamic banks cannot realistically expect to grow further if they lag behind their conventional peers in digital services. Given that millennials have a clear preference for conducting their banking services on digital platforms, digital banking could become a significant client segment for Islamic banks, and an important tool in becoming customer-centric. Hence, the adoption of next-generation technologies is no longer a choice, but an absolute imperative for Islamic banks to continue to gain market share.

Not only should Islamic banks undertake digitization initiatives in the areas of mobility and e-banking but they should also broaden their focus toward gaining predictive insights using analytics. The more granular the insight, the better Islamic banks will be able to target their communities with innovative and relevant product offerings.

The constant digital interaction between Islamic banks and their customers is particularly valuable as it provides insights into key demand drivers of banking services such as customers' attitudes and needs. Islamic banks can leverage on customer data, which would in turn support the tailoring of specific banking products. In a relatively new and fast-growing market such as Islamic banking, these types of information are particularly invaluable as they would enable Islamic banks to better gauge customer preferences for Shariah compliant services.

Driving business value with artificial intelligence

Artificial intelligence is a hot topic these days and it is taking centre stage in banking, for it will challenge the traditional banking model and create immense potential for innovations.

Basically, artificial intelligence was created to pursue two goals: improving the understanding of human behavior, and making people's lives easier. So it will not only simplify banking for a specific behavior pattern, but it will do so for millions of people who have very diverse banking needs. The fact that artificial intelligence is able to recognize so many different patterns makes it so revolutionary and attractive.

Besides analyzing financial behaviors to tailor the services desired by their customers, for Islamic banks, using artificial intelligence will help them reduce inefficiency in their internal processes and reimagine and restructure operating models, as this powerful tool is capable of identifying issues to make adjustments much sooner than is possible today, thus increasing accuracy and eliminating multipronged efforts.

The explosive growth of new technologies has created the perfect platform for the expanded use of artificial intelligence in banking services. The benefits of artificial intelligence are widespread, reaching back office operations, compliance, product delivery, risk management, customer care and marketing, to name a few. It is garnering universal appeal because of its ability to build knowledge at high speeds, understand natural language and run operational processes in a fully compliant fashion.

In tomorrow's clever banking, taking advice on a Shariah compliant investment from a machine is just the beginning in the relentless march of technology disruption.

Recent developments in Islamic capital markets – green Sukuk

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Climate change is a global threat to the world and society at large. The effect of climate change can be seen everywhere in the biosphere. The 2015 Paris Climate Accord set a global action plan for participating governments to avoid a dangerous climate by limiting global warming to well below 2ºC above pre-industrial levels. Malaysia is one of the countries that has committed to reducing carbon emission by 45% by 2030 and the sustainability of 50% of its forest cover in order to combat climate change. This presents a significant opportunity for green finance to be part of investment or funding activities to finance related environmental businesses or projects around the world.

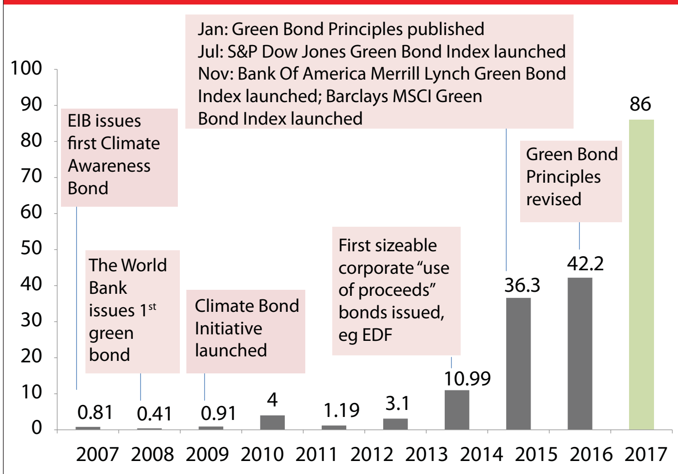
Apart from the supply side, the main growth factor for green bonds is also due to the growing investor demand for responsible financing assets shown by the oversubscription rate of all green bond issuances in the past. The issuance for green instruments today is increasing rapidly and according to Danajamin Nasional, 2016 was a record year for green bonds with US$86 billion (see Chart 1)-worth of issuances globally, double the issuances in 2015 of US$42.2 billion.

> The ASEAN GBS is intended to provide additional guidance on the application of the GBP, as well as to enhance transparency, consistency and uniformity of ASEAN green bonds

Green bonds are debt-capital instruments that offer the same characteristics as a normal bond in terms of ranking, rating, pricing and the issuance process. The only difference is the use of proceeds dedicated to strong environmental and social businesses or projects and also the disclosure commitment by the issuer to continuously monitor and report on the progress of the green projects. The ultimate objective of green bonds is to facilitate financing toward environmentally-friendly solutions that can help mitigate the effects of climate change and also create value for the surrounding ecosystem.

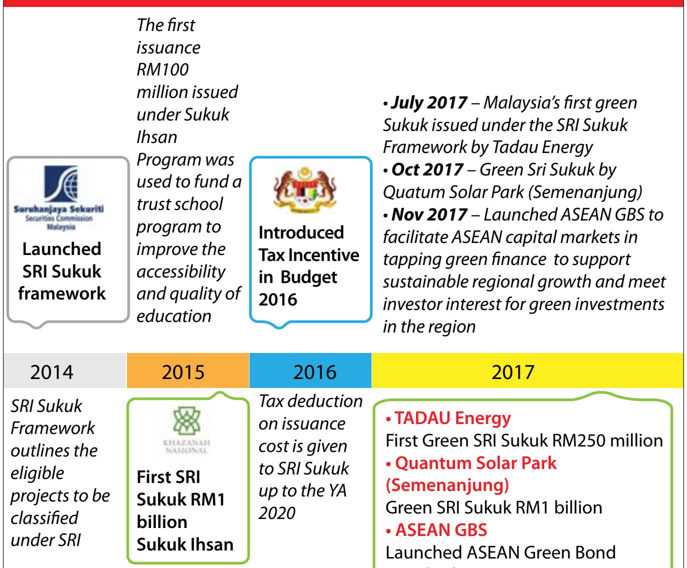
In 2007, the first green bond was issued by the European Investment Bank followed by an issuance by the World Bank to facilitate institutional investors' request in financing environmental-friendly projects. There was a turning point in the market when the first corporate green bond was issued in November 2013 by Credit Agricole with an issuance of US$220.7 million for sustainable energy projects.

Chart 1: Issuance of green bonds (US$ billions)



Source: Climate Bonds Initiative, Barclays MSCI, EY Green Bonds report 2016

Diagram 1: Key milestones in SRI/green Sukuk development in Malaysia



Source: Author's own

From the Islamic finance point of view, the green sector is well-received as Shariah compliant due to its characteristics, ie to protect the environment and society at large. The green Sukuk market, however, is only now gaining traction compared to its counterparts on the other side and this could be due to various factors. As we can see, in the active markets in Islamic finance, ie Malaysia, Indonesia, Turkey and the Middle East itself, green finance is still in its infancy. The main stakeholders are still building up their capabilities on their respective green mission statements while there is still a lack of availability of green projects. The investors in the region have yet to develop their own green mission statements for investment purposes. Economic challenges such as the drop in commodity prices in recent years have been hampering innovation and issuance in certain parts of the region, which could also be one of the factors for green finance still in its infancy.

Development of green Sukuk in Malaysia

Malaysia's lead in innovating SRI and green Sukuk is underpinned by its pioneering work in regulating the sector through the Securities

Table 1: List of green and SRI Sukuk in Malaysia

PNB Merdeka Ventures *ASEAN Green SRI Sukuk (to be issued)*	• **Shariah principle:** Murabahah (via Tawarruq) • **Use of proceeds:** To fund the 83-storey office space, which forms part of the Merdeka PNB118 Tower project.
Sinar Kamiri, *Green SRI Sukuk (to be issued)*	• **Shariah principle:** Wakalah Bi Al-Istithmar • **Use of proceeds:** To finance the development of a solar photovoltic (PV) energy-generating facility of 49MWac in Sungai Siput, Perak.
Quantum Solar Park (Semenanjung), *Green SRI Sukuk (Oct 2017)*	• **Shariah principle:** Murabahah (via Tawarruq) • **Use of proceeds:** To finance the construction of three 50-megawatt (50MW) alternating current solar photovoltic (PV) power plant in Gurun (Kedah), Machang (Terengganu) and Jasin (Melaka).
Tadau Energy, *First Green SRI Sukuk (July 2017)*	• **Shariah principle:** Istisnah and Ijarah • **Use of proceeds:** To finance the large-scale solar project of 50MW in Kudat, Sabah
Ihsan Sukuk by Khazanah Nasional, *First SRI Sukuk (June 2015)*	• **Shariah principle:** Wakalah Bi Al-Istithmar • **Use of proceeds:** To channel funds to Yayasan AMIR, a non-profit organization to improve the accessibility of quality education in Malaysia

Source: Author's own

Table 2: Examples of eligible green projects

Natural resources	**Renewable energy and energy efficiency**	**Infrastructure and information technology**
Sustainable land use	New or existing renewable energy	Commercial/ residential/public green buildings
Biodiversity conservation	Efficient power generation and transmission systems	Community services
Redevelopment of polluted sites	Reduction of greenhouse gas emissions or energy consumption	Fuel efficient/electric vehicles
Water infrastructure treatment and recycling	Energy storage systems	Efficient transportation systems
Sustainable waste management projects		Technology substitution/products that support smart grid applications

Source: Author's own

Commission (SC)'s Sustainable and Responsible Investment (SRI) framework, established in 2014 to facilitate the financing of SRI initiatives. The introduction of the SRI Sukuk framework is in line with the rising trend of green bonds and social impact bonds that have been growing globally. The green sector is the subset of the SRI Sukuk framework which has listed down relevant sectors which are eligible to be classified as SRI. Under the SRI Sukuk framework, there are several incentives provided to attract the issuance of SRI or green Sukuk, one of which, among others, is the tax deduction until the year of assessment of 2020 on the issuance costs of SRI or green Sukuk approved, authorized by or lodged with the SC.

> "The funding needs of green projects/businesses will give a greater role to Islamic finance to participate in these green and socially responsible projects"

In July 2017, the SC announced the issuance of Malaysia's very first green Sukuk under the SRI Sukuk framework by Tadau Energy for a solar power project. Tadau Energy's green SRI Sukuk issuance marks an innovation that would spur growth in green and sustainable finance, henceforth strengthening Malaysia's leading position in Islamic finance particularly in the Sukuk market. This is also the result of close collaboration between the SC, Bank Negara Malaysia (BNM) and the World Bank to develop an ecosystem to facilitate the growth of green financing with aspirations to make Malaysia the hub for green Islamic finance. Table 1 shows the list of green/SRI Sukuk in Malaysia that have been issued or are in the pipeline/announced. ASEAN Green Bond Standards to be the growth driver for green Sukuk in the region

There are already a few frameworks or standards that have been developed to facilitate the issuance of green bonds/Sukuk. The most pertinent one is the introduction of the Green Bond Principles (GBP) issued by the International Capital Market Association in January 2014 which saw the green bond market tripled in issuance size for the relative year. Recently, ASEAN launched a framework known as the ASEAN Green Bond Standards (ASEAN GBS) on the 8th November 2017 that will act as a catalyst for the issuance of green bonds/Sukuk in funding green projects in ASEAN countries.

The ASEAN GBS are aligned with the GBP. Both standards provide issuers with guidance specifically on the four core components in issuing green bonds/Sukuk comprising the use of proceeds, the process for project evaluation and selection, the management of proceeds and reporting. However, the ASEAN GBS is intended to provide additional guidance on the application of the GBP, as well as to enhance transparency, consistency and uniformity of ASEAN green bonds.

As mentioned previously, the ASEAN GBS are intended to provide some key additional features on the application of the GBP. Table 3 shows the key additional features of the ASEAN GBS.

Areas of innovation

If we are to do an analysis, green Sukuk which have been issued in Malaysia are all based on several corporates' green project initiatives. These represent a fraction of the various types of green bond issuances in the global market. Alternatively, Islamic financial institutions can consider issuing a 'green use of proceeds' Sukuk, whereby the Sukuk proceeds will be earmarked specifically for various green projects to be identified by the Islamic financial institutions from time to time. This structure will be strategically in line with the Islamic financial institutions' direction toward the implementation of the Value-Based Intermediation (VBI) initiatives which had been mooted by BNM in August 2017. As presented by BNM, the VBI initiatives are to ensure the Islamic financial institutions unlock the full potential of Islamic finance through economic value creation while upholding ethical values.

Another type of green Sukuk is the 'pure play' green Sukuk, ie large corporations issuing green Sukuk as their nature of business stems from environmental sectors and the proceeds can be used for their general working capital.

As the introduction of green Sukuk is relatively new to ASEAN markets, there could be some initial drawbacks as the market continues to promote more of this green financing sector. The main challenge to the issuer is the additional cost attached by issuing green Sukuk whereas the same instrument provides the same return as any other normal Sukuk. Traditional fixed income investors will still look at credit rather than the green tagging. These costs, as mentioned, may include the external review, monitoring and reporting of the performance of the projects to investors.

Green Sukuk also carry an inherent reputational risk as the instrument needs to portray itself as socially responsible. However, with progressive development and awareness, these minimal challenges shall be outweighed by the benefits of issuing green Sukuk over the long term. In addition, to alleviate this issue, the SC provides a green SRI Sukuk grant amounting up to RM6 million (US$1.46 million). The purpose of this grant is to finance the external review expenditure incurred by the issuer of up to a maximum amount of RM300,000 (US$72,882.8), to encourage the issuance of green SRI Sukuk. In the recent Budget 2018, it is proposed that income tax exemption be given to recipients of the green SRI Sukuk grant used for the purpose of financing the external review expenditure, in line with the objectives of the SC.

> "The concept of green and sustainable and responsible finance or investments encourages corporate social responsibility and the protection or preservation of society which are certainly in line with the principle of Maqasid Shariah (the desired objectives of the Shariah)"

Sukuk is an important instrument in Malaysia to fund long-term projects ranging from infrastructure, property, healthcare, oil and gas, telecommunications, transportation, education and so forth. The funding needs of green projects/businesses will give a greater role to Islamic finance to participate in these green and socially responsible projects. Although green and SRI Sukuk is a nascent market in Malaysia, there is great potential for green Sukuk in the future due to growing interest in green and sustainable and responsible financing and as an alternative source of funding other than the bank market or equity financing.

Table 3: Key additional features of the ASEAN GBS

Eligible issuers	• ASEAN Issuer • In case of a non-ASEAN issuer, the eligible green projects shall be located in any of the ASEAN countries.
Ineligible projects	Fossil fuel power generation projects are excluded from the eligible green projects.
Continuous accessibility to information	Issuer is required to disclose information on the (i) use of proceeds; (ii) project evaluation and selection and (iii) management of proceeds to investors in the issuance documentation and such information is publicly accessible from a website designated by the issuer's website throughout the tenor of green bonds/Sukuk.
Encourage more frequent reporting	Issuers are encouraged to provide more frequent periodic reporting in addition to annual reporting to increase transparency on the allocation of proceeds and investors confidence.
External review	Appointment of an external review is voluntary. The external reviewer must have relevant expertise and experience on the area they are reviewing. The credentials and scope of review conducted must be made publicly accessible on the issuer's website throughout the tenor of the green bonds/Sukuk.

Source: ASEAN GBS Standards

With the collaborative efforts between regulators and industry practitioners to promote green Sukuk, we will likely see more green Sukuk issuances which will support Malaysia as the center of innovation for Islamic finance. The concept of green and sustainable and responsible finance or investments encourages corporate social responsibility and the protection or preservation of society which are certainly in line with the principle of Maqasid Shariah (the desired objectives of the Shariah).

Participation asset management: A long way to go

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As it offers a totally different model than conventional finance, it has got to have a different name; however, neither 'Islamic finance (or Shariah compliant finance)' – the term commonly used – nor 'non-interest bearing (interest-free) finance' are necessarily the right terms. This is because:

1) The alternative is not Judeo-Christian finance. There is no need to put a religious tag as it is not meant for Muslims only, nor does it mean that non-Muslims cannot utilize this financial system. Although this one is affirmative, it is like using the term 'Islamic terrorism'! The very reason why we reject the 'Islamic' tag in Islamic terrorism may well be asserted for 'Islamic finance'.

2) The only differentiating feature of this system is not just being 'interest-free'. There is much more to it, with the main ones being:
   - (i) sharing risks and rewards (sharing 'Rizq' with 'Rizq' meaning 'everything given by God for livelihood; according to some linguistics, it is believed to be derived from the word 'risk')
   - (ii) not engaging in forbidden transactions or investments such as gambling, alcoholic beverages, drugs, etc, that are detrimental to society
   - (iii) avoiding unclear terms in contracts that may end up in a hazardous sale or deception
   - (iv) being environment-friendly, and
   - (v) decent corporate governance.

The essence is participating in risks and rewards, hence the term 'participation'. It is by definition embracing all people whether Muslim or not and it is already gaining traction in financial jargon.

Finance stands on four pillars: banking, asset management, insurance and other financial intermediations (such as leasing, forfaiting, factoring and so on). There are clear differences between participation and conventional alternatives of banking and insurance systems. Other intermediation is kept out of discussion as they have to be discussed one by one which is beyond the scope of this article, for example, leasing is in essence compliant with participation principles whereas factoring is not at all by its nature.

However, it is not the case when it comes to asset management. We need to establish the participation alternative of asset management together with its distinguishing principles, institutions, products and services.

Notwithstanding the current stagnant outlook, there is quite an interest and potential in participation asset management. Muslim countries' sovereign wealth funds (SWFs) are larger than US$2.5 trillion — the demand.

Meanwhile, emerging markets such as Turkey, Malaysia and Indonesia offer high yields in vast amounts of investment opportunities – the supply. The match between the two would not only serve the economic purposes but would also strengthen ties between Muslim nations. On the other hand, lucrative investment opportunities in emerging markets are of interest to all investors in the world, especially the developed world craving for returns. Also environmental, social and governance investors are very comfortable with participation finance, creating additional demand.

Review of 2017

2017 has been a year of cooperation among participation finance firms in setting up new equity and real estate investment funds. The two prevailing issues of financial illiteracy and complex regulations do not seem to be resolved yet resulting in slow growth of assets under management (AuM) in participation asset management.

Financial illiteracy is in fact a general problem within the finance sector, and even a more severe one within the participation part. Nevertheless, we have seen initiatives to train students and teachers about finance led by NGOs in Malaysia and Turkey.

Regarding the regulatory environment in general, the lack of one universal standard-setting body for the whole participation finance industry remains a major challenge in its global recognition and acceptance. Although there are bodies like AAOIFI (Bahrain) and the IFSB (Malaysia), there can also be a higher authority, say at the Committee for Economic and Commercial Cooperation of the Organization of Islamic Cooperation (COMCEC) level, playing the joint role of the Basel Committee and the International Organization of Securities Commissions.

Meanwhile, there are new regulatory developments in Morocco and Turkey to develop participation finance institutions and products. Morocco started Shariah compliant banking in early 2017 and Turkey enacted an auto-enrolment private pension regulation whereby participation pension funds have to be made available by all pension companies. Turkey also set up a sovereign wealth fund and stated bolstering participation finance as one of its main objectives.

Preview of 2018

In 2018, participation asset management will be more popular due to the rise in IPOs in the Muslim world triggered by the upcoming IPO of Saudi Aramco. In addition, low oil prices will lead some oil-rich Muslim investors to utilize products and services in participation asset management, further leading to increased AuM.

There are also initiatives to improve cooperation among the exchanges of COMCEC member states which may facilitate the cross-listing of stocks and easy access to a wider investor base.

Another initiative, based on the fact that investors in Muslim countries have a tendency to invest in real estate, is to set up a real estate exchange whereby properties in COMCEC member states would be traded. Real estate investment funds can also play a significant role in attracting foreign investors into the property markets.

The world economy is finally expected to get into a growth stage in 2018. Therefore, we may expect private equity deals to increase and hence, an opportunity for participation asset managers to set up private equity investment funds (PEIFs) and provide investors with potential high returns derived directly from the growing businesses.

Conclusion

As the title or this article suggests, there is a long way to go for participation asset management. Improving financial literacy, developing international standards, engaging SWFs and private pension systems so that they are encouraged to move into the industry, launching new venues of close cooperation among Muslim countries via joint exchanges or PEIFs are all the very first steps to be taken to bolster participation asset management.

Considerable growth in 2018 and beyond for Islamic cross-border capital flows

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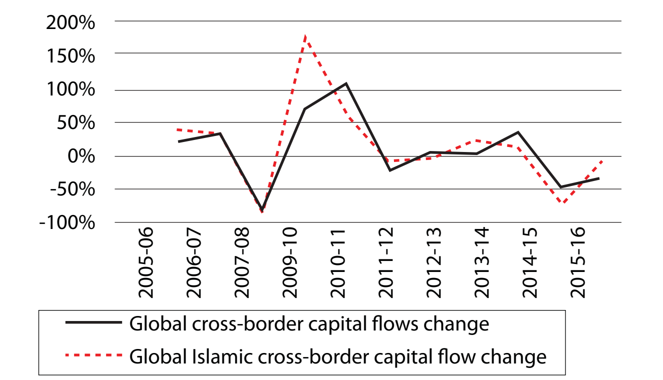
The IMF Balance of Payment statistics identified five main types of capital flows: foreign direct investment (FDI); portfolio investment (foreign purchases of equity and debt securities); foreign reserve assets of central banks; lending and other investment; and derivatives. The gross global cross-border capital flows comprise the annual foreign capital inflows and outflows between a country and the rest of the world. Their value is determined by the sum of capital inflows or capital outflows, as they should be roughly the same, though discrepancies may occur due to measurement. Islamic participation, by way of the share of Shariah compliant instruments, in any of those types of flows is what may be considered as global Islamic cross-border capital flows.

Review of 2017

The McKinsey Global Institute (MGI) reported that gross global cross-border capital flows have shrunk by 65% from US$12.4 trillion in 2007 to US$4.3 trillion in 2016. Half of that decline reflects a sharp reduction in cross-border lending and other banking activities in the eurozone. Meanwhile, the considerable rise in FDI and equity flows to 69% from 36% before 2007 of cross-border capital flows signifies future stability. Furthermore, MGI reported that the gross global financing assets in 2016 were US$132 trillion, and the global cross-border flows were US$4.3 trillion or the equivalent to 3.3% of all financial assets.

In contrast, the IFSB reported that the global assets of the gross value of the global Islamic financial services industry in 2016 were estimated at US$1.9 trillion as at the 5th November 2017, and included: Islamic banking (US$1.5 trillion for the six months ended June 2016), Sukuk outstanding (US$318.5 billion for the full year of 2016), Islamic funds' assets (US$56.1 billion for the full year of 2016) and Takaful (US$25.1 billion as at the end of 2015). Accordingly, the assets of the global Islamic financial services industry represent approximately 1.4% of global financing assets.

Chart 1: 10-year change in global Islamic cross-border capital flows (2005-16)



Source: Author's analysis

If we assume that the global Islamic cross-border financing flows would follow the same pattern as global cross-border capital flows, then an equivalent 3.3% of all Islamic financial assets would be approximately US$62.7 billion. To confirm this conjecture, an examination of the IMF Balance of Payments statistics for the 2005-16 period was carried out to determine the Islamic portion of global cross-border capital flows according to the historical Islamic participation rates in cross-border banking and finance (GCC 34%, ASEAN 13%, Southeast Asia 12% and Turkey and ROW 6%). The analysis revealed that this rudimentary calculation was understating the steady growing share of global Islamic cross-border capital flows of the gross global cross-border capital flows which were approximately US$335.8 billion or 3.3% of the global gross cross-border capital flows in 2005, growing to US$603.7 billion (6.3%) in 2013, and then falling to US$109.5 billion (4%) in 2016.

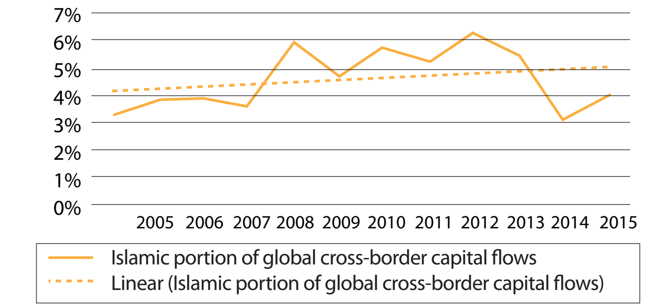
The decline in the gross global Islamic cross-border capital flows have declined by -73% during 2014-15 and -10.2% during 2015-16, which was similar to the decline in the gross global cross-border capital flows over the last couple of years, falling by -51.1% during 2014-15 and -32.1% during 2015-16. No doubt, the historically low oil prices with geopolitical instability in the aftermath of the Arab Spring, and the rise of economic and anti-Islamic nationalists in Europe and elsewhere, have contributed to a diminishing appetite for Islamic banking and finance as Islamic financial entities have to contend with serious reputational risk pressures to their bottom lines.

Preview of 2018

In contrast, there is cause for optimism with the powerful forces of global Muslim population growth, emerging economies growing faster than advanced economies, rising affluence and economic participation, increased demand for ethical investments, rise in Islamic financial centers; sophistication of Shariah compliant finance; harmonization and integration of Islamic financial practices to global accounting and risk management standards; and rapidly growing global Sukuk issuance.

One particular powerful force that is of note is Hong Kong becoming the first 'AAA'-rated government in the world to issue a dollar-denominated Sukuk (three worth US$3 billion were issued since the 11th September 2014). The issuance of Sukuk and Shariah compliant financial instruments must be viewed within the context of financing the infrastructure needs of China's 'One Belt, One Road' (OBOR) strategic economic partnership with its historical 'silk road' partners across Eurasia where 40% of OBOR countries are Muslim. Recent developments in the Middle East and Southeast Asia that are an extension of some of these forces offer a great cause for optimism that is nonetheless supported empirically by a trend incline since 2005 in the Islamic share of cross-border transactions (see Chart 2).

Chart 2: Islamic portion of global cross-border capital flows (2005-16)



Source: Author's analysis

On the 22nd October 2017, the Saudi Arabian Monetary Authority joined AAOIFI, which promises to boost cross-border deals, while on the 3rd November 2017, a digital free trade zone (DFTZ), the brainchild of Jack Ma of Alibaba, went live enabling more than 2,000 Malaysian SMEs to capitalize on cross-border e-commerce activities. The Malaysian DFTZ capitalizes on the rise of fintech, machine learning and blockchain technology, which would enable more secure and lower-cost Islamic cross-border financing flows. Furthermore, peer-to-peer lending, funding and payment platforms may broaden global participation in Islamic banking and finance. On the other hand, regtech platforms may be used to manage risks associated with Islamic cross-border capital flows. The evolution of the Islamic finance industry into a more sustainable ecosystem with over 1,291 financial institutions in more than 85 countries means that it can contribute to the economic development of emerging economies, of which many are Muslim, and profit-sharing diplomacy for global players seeking to advance their interests in Africa, the Middle East, Europe and Southeast Asia.

Conclusion

These initiatives are taking place against the US$1 trillion investment by China in its bold, innovative and strategic OBOR project that spans more than 68 countries and 4.4 billion people that collectively comprise 40% of the global GDP. To date, more than 25 member countries of the OIC have joined the OBOR initiative, while 22 Arab countries have various agreements and treaties with China. Currently, China is the largest single trading partner for the OIC bloc, and the second-largest for Arab countries as a whole. China's OBOR long-term strategic project offers an infrastructure backbone of maritime, land and digital trade, which would accelerate the global growth in cross-border trade and finance. In conclusion, the OBOR geoeconomic initiative coupled with technological innovations in global Islamic cross-border trade and finance certainly promises considerable growth in 2018 and beyond.

Islamic institutional investments set for greater heights

This article is contributed by the Islamic Financial Institutions Division of the Advisory Services Department at the Islamic Corporation for the Development of the Private Sector (ICD) of the IDB Group.

The global Islamic finance industry is worth over US$2 trillion today. The industry has maintained its trend toward growth despite global challenges of low oil prices, political uncertainties and weak trade that have affected the major Islamic finance markets around the world. The resilient growth of the industry has translated into the growth of Islamic institutional investments over time. Islamic institutional investments encompass largely the pool of investment around Islamic banks, Islamic funds, Sukuk and Takaful companies. There have been considerable developments in institutional investments over the last few years.

> Islamic finance is a service-driven industry and as such, the quality of human resources will ultimately drive the future growth of the industry globally

Review of 2017

Islamic banks

The global Islamic banking asset size has surpassed US$1.45 trillion, according to the ICD–Thomson Reuters Islamic Finance Development Report 2016 (the 2016 Report), this being the largest component of the Islamic finance industry. It consists of over 480 fully-fledged banks and windows. New Islamic banks or Islamic windows of conventional banks are attracting growing institutional investments. In 2017, the central bank of Morocco, Bank Al-Maghrib, issued Islamic banking licenses for the first time to five banks. The Islamic Corporation for the Development of the Private Sector (ICD) committed to bringing growth capital of 49% for the establishment of an Islamic bank (Al-Akhdhar) in the Kingdom of Morocco. Also, the ICD through its IB Growth Fund (Labuan) made a strategic investment of US$15 million in Amana Bank, Sri Lanka.

Jordan-based Bank Al Etihad and Etihad Islamic Investment Company acquired a 20.8% stake in Jordan Dubai Islamic Bank. Dubai Islamic Bank launched operations in Kenya. We saw new jurisdictions making accommodating regulations to unlock institutional investments in Islamic banking in countries such as Algeria and Malawi.

Islamic funds

Shariah compliant funds are one of the growing classes of institutional investments worth over US$66 billion, according to the 2016 Report. In 2017, CIMB-Principal Asset Management launched the Islamic Global Emerging Markets Equity Fund with a target fund size of RM300 million (US$71.43 million). The ICD in partnership with Ibdar Bank, a Bahrain-based wholesale Islamic investment bank, and the Labor Fund 'Tamkeen', initiated the process of launching a US$100 million Bahrain SME Fund. The ICD also approved the creation of the first African Infrastructure Islamic Finance Fund aimed at providing Shariah compliant financing to infrastructure projects in Africa. The Employees Provident Fund of Malaysia also decided to allocate RM50 billion (US$11.91 billion) to its Islamic fund in 2018. In the venture capital space, the IDB and Malaysia partnered for the establishment of the first-ever Islamic venture capital fund with an initial size of US$100 million. Securities Commission Malaysia also launched an Islamic fund and wealth management blueprint to promote Islamic wealth management and provide an overall boost for institutional investments in the Islamic finance market.

Sukuk

Sukuk have been an attractive investment class for institutional investors globally and have an outstanding value of over US$342 billion, according to the 2016 Report. It is currently the fastest-growing component of the Islamic finance industry which is not unconnected with the decline in oil prices that has encouraged sovereign Sukuk issuances globally.

To offset the budget deficit, Saudi Arabia issued an international Sukuk facility for the first time amounting to US$9 billion. It also issued a US$10 billion domestic Sukuk facility. Oman issued sovereign Sukuk worth US$2 billion while Indonesia issued two sovereign Sukuk worth US$3 billion. Furthermore, Nigeria issued its first sovereign Sukuk worth NGN100 billion (US$276.95 million). The issuances from first-time issuers, among others, has driven a lot of institutional investments into this fixed income asset class (Sukuk) globally.

Takaful companies

Takaful has an asset size of over US$38 billion, according to the 2016 Report, with a double-digit growth rate and dominated mainly by Saudi Arabia, Iran and Malaysia. Among the few transactions in the Takaful segment in 2017 was Bahrain Kuwait Insurance's acquisition of a 36.31% stake in Takaful International.

Preview of 2018

We are likely to see more institutional investments in the creation of Islamic financial institutions in Africa, as more and more African countries open up their economies with an enabling environment for Islamic finance investments. We may see a flurry of Sukuk issuances across the world to help offset the budget deficit caused by low oil prices and other global challenges. The UK is working toward another Sukuk issuance to raise funding for the government. It is likely SMEs will be promoted to drive growth by attracting Islamic funds. The banking sector in the GCC may see mergers and acquisitions to weather low oil prices that have dried up deposits and escalated non-performing loans.

However, to realize the potential, we need to keep developing robust Islamic banking regulations and improving corporate governance. Islamic finance is a service-driven industry and as such, the quality of human resources will ultimately drive the future growth of the industry globally.

Conclusion

Overall, the global Islamic industry is set for greater heights with the advent of new jurisdictions introducing Islamic finance to unlock previously untapped potential and to further increase financial inclusion in their respective jurisdictions.

2018 could be the most important year for Islamic crowdfunding yet

***Craig Moore** is the founder and CEO of Beehive. He can be contacted at craig@beehive.ae.*

Crowdfunding, the process of asking a large number of individuals or investors to provide relatively small investments (or donations) to fund a business, project or venture, continues to prove a popular form of alternative finance globally. While market estimates regarding future growth can vary, with some predicting a slight softening of the market and other frequently referenced sources, such as the World Bank, suggesting continued growth, no one can underestimate the potential this industry has for development.

Within the wider crowdfunding industry, there are some particularly exciting segments, such as Islamic crowdfunding, which show strong future potential for growth. Crowdfunding has a natural fit with Islamic principles, being based around the idea of promoting entrepreneurialism and sharing risk and many crowdfunding ventures ultimately benefit the community. The natural combination of crowdfunding and Islam, as well as an increasingly young, tech-savvy and growing Muslim population expecting an array of convenient, Islamic finance products, makes for interesting times. Crowdfunding is recognized as an important area of the growing fintech (financial technology) industry. Advancements in technology continue to drive the way consumers behave and equally the way businesses deliver products and services. This influence opens up exciting new prospects for Islamic fintech and its relative subsectors such as Islamic crowdfunding.

Review of 2017

2017 was certainly the year of fintech. In relation to Islamic crowdfunding, 2017 has proven to be an important year of seeding the ground for growth and progression. A notable step in many markets has been the establishment of regulatory infrastructure. Authoritative bodies across Southeast Asia and the Middle East have identified the critical role of robust yet flexible regulatory frameworks in facilitating the development of a globally competitive fintech industry. As a result, they have moved quickly to collaborate with fintech players to develop and implement regulations that support the growth and advancement of this important new industry and to lay a strong foundation for becoming progressive fintech pioneers.

2017 has also been the year of collaboration. While conventional banks and crowdfunding platforms have fostered collaborative partnerships over the past couple of years, 2017 has been the year where Islamic banks have begun to recognize the important role that new fintech players in the crowdfunding space can play in helping to propel the growth and influence of Islamic financial institutions. These are early days but invariably this is the beginning of exciting partnerships between traditional and alternative service providers to the benefit of the greater Islamic community.

Other forms of collaborations have also prospered, with new cross-country collaborations frequently being reported in the media as different markets recognize that pooling resources and sharing knowledge and learnings can be of significant mutual benefit in developing their respective fintech industries. Cross-country collaborations will be key to defining the most globally competitive and ultimately successful markets in the race to be a global fintech capital.

Preview of 2018

Technology underpins the future development of Islamic crowdfunding, as well as the wider Islamic finance industry, in the new year. The benefit of technology is that it opens up Islamic finance to a far broader audience than has historically been the case. Now, more than ever, Islamic finance, including fintech-based businesses such as Islamic crowdfunding, is generating a more mass appeal, appealing to both Muslim and non-Muslim investors and businesses attracted by fair business finance terms, healthy returns and an ethical, alternative asset class. All of these attributes drive the interest and involvement of a wider audience base and are key to accelerating growth.

Greater collaboration between crowdfunding platforms and other key parties is almost a certainty as banks, regulators and authorities understand the importance of outlining clear guidelines for the establishment and future prosperity of fintech-based businesses and the positive contribution they can make to the economy. Islamic banks, already interested by the developments in fintech, have begun to strike alliances with fintech companies which can provide the agility and speed that traditional financial institutions require in order to make significant progress in a new world of tech-based finance.

> “Technology plays a key role in broadening the appeal of Islamic finance (traditional and alternative forms) to both Muslim and non-Muslim customers and across borders”

As the industry evolves and markets move quickly to implement comprehensive regulations, this will undoubtedly drive greater participation overall as investors and businesses take comfort in a more regulated and inclusive industry, no longer the domain of only the early innovators.

Conclusion

2017 has demonstrated exciting indications for the imminent future and prosperity of the fintech industry and with it, Islamic crowdfunding. With so many countries vying to take the title of Islamic fintech capital, the race is on to establish the most accessible regulatory frameworks, the most beneficial cross-market collaborations and the most attractive destination for fintech entrepreneurs to establish themselves. Technology plays a key role in broadening the appeal of Islamic finance (traditional and alternative forms) to both Muslim and non-Muslim customers and across borders.

2018 looks set to be an exciting year for Islamic crowdfunding. Already hot on the heels of conventional crowdfunding, it has an engaged and growing audience to satisfy. Building on the progress of 2017, Islamic banks are taking serious interest in the new breed of Islamic fintech players and Islamic crowdfunding platforms offer a very interesting and lucrative approach for them to divert funds to finance Shariah compliant businesses, projects and ventures. With a burgeoning market, increasing customer awareness and considerable interest across the board, 2018 could well be the most important year for Islamic crowdfunding yet.

Islamic leasing: A decent year for Shariah compliance

Shoeb M Sharieff *is the president and CEO of Ijara Community Development Corp. He can be contacted at shoeb@ijaracdc.com.*

When you make a high-level overview, it's not hard to see why Islamic leasing had a pretty good year in 2017. Promoting Shariah compliant business in this manner is one central function of Islamic leasing. This is quite often the method used by Islamic banks when the business needs to finance machinery or other assets like mortgages without worrying about Riba.

Because the bank generally buys the asset and leases it to the customer, this structure is considered one of the most Shariah compliant in the Islamic financial world. Like a lot of other Islamic finance structures, the ownership of the lease is transferred at the end of the contract.

Review of 2017

Larger sector

First of all, it's important to establish how Islamic leasing has blended into the larger Islamic financial sector and done its part to boost this business in 2017. Recently, the Central Bank of the UAE's latest statistical bulletin told the full story. They reported that assets from Islamic banking and leasing in the region grew 59.42% faster year-on-year than that of conventional banks between July 2016 and July 2017.

The US story paints a similarly rosy picture for 2017. Capital in Islamic banks has grown from US$200 billion in 2000 to US$3 trillion in 2016 alone. The number is expected to go up to US$4 trillion in the next three years. Consider too there are currently 300 Islamic finance banks and 250 mutual funds that are Shariah compliant around the world today.

Leasing capabilities

There were 25 financing institutions in the US that offered leasing capabilities in 2016. EY reported that the number of US institutions offering leasing services will expand through 2018.

However, taking a look at the roller-coaster ride for Islamic leasing in 2017, it's easy to see the concept continues to pick up momentum. Let's start by looking at some of the positive news that came out of this sector of Islamic banking in the past year.

Good news

Aayan Leasing and Investment Co, based in Kuwait, is a closed shareholding company that had some good news to report from their leasing sector. It seems the company was at the front end of a trend that started in the summer. As of the 26th July, its net profit was KWD4.7 million (US$15.51 million). This compares very well with the KWD724,919 (US$2.39 million) they attributed to their shareholders only one year ago.

2017 also saw some interesting alignments in the innovative digital sector which included Islamic leasing arrangements. In particular, the Dubai Silicon Oasis Authority signed an agreement with global company Visa. The fintech sector in the area is hoping to take advantage of particularly the innovative technologies of large payment processors in Dubai. The MoU between the two partners was signed in September 2017. It's a clear indication of the globalization of this part of Islamic banking and of course leasing will play a central role in the exchange of technologies.

There were other interesting developments around Ijarah Wa Iqtina (lease-ending ownership) and property owners in the Middle East generally and Saudi Arabia specifically. Riyadh's National Transformation Program is attempting to increase the number of homeowners in that area. The new goal is 52% by the year 2020. That would represent a jump from the present 47%.

Preview of 2018

The Saudis are taking a two-pronged approach to accomplish this goal. The first is the central bank putting aside more money for the Islamic leasing option. The second involves partnering with an Asian firm to build one million low-cost homes in 2018. Both of these projects will necessarily mean an increase in lease-ending ownership.

Moody's has predicted that the UAE's leasing and banking foundations will stay strong well into the next year. They cite several conditions including economic resilience as well as strong capital funding in the leasing sector; net income is expected to be approximately 1.5-1.7% of tangible banking assets over the next 12-18 months.

We have already discussed in previous articles how many Islamic leasing trends originated in the Middle East and spread to North America and other parts of the world. That means 2018 should see a trend and proliferation of this type of Ijarah financing.

Conclusion

The final word in the leasing sector once again goes to the Saudis. They are so confident in the economic picture emanating from their country that they recently held a rare press conference. Ahmed al-Kholifey is the central bank governor in Saudi Arabia who necessarily works closely with Islamic leasing. He acknowledged some headwinds including negative consumer price inflation and rising unemployment. However, his statement about ample liquidity in the system reflects the overarching theme of a positive year in 2018 for Islamic leasing.

Islamic microfinance: Can fintech revolution accelerate growth?

Dr Mohammed R Kroessin *is the head of Islamic microfinance at Islamic Relief. He can be contacted at mohammed.kroessin@irworldwide.org.*

The conventional microfinance sector is currently awash with buzzwords such as fintech, blockchain and digital money. This is to some extent because traditional microbanking generally is struggling to remain relevant amidst a shrinking of business due to market saturation and technological advances. This article examines the market outlook for Islamic microfinance to assess whether and how the fintech revolution can become a game-changer for Shariah compliant financial inclusion.

Review of 2017

The Islamic microfinance industry has been steadily growing, now providing access to financial services to some 2.5 million poor people of which over 85% live in Bangladesh, Indonesia, Pakistan and Sudan. The sector is made up of an estimated 300 financial services providers, mainly NGOs and cooperatives, but many do not report on the industry data repository, the MIX Market.

One of the major developments has been the digitization of the whole microfinance industry. Completely paperless lending is now happening and spreading quickly. From application to credit scoring and disbursement to repayments, all transactions and interactions can be digitized. This transformation significantly reduces the cost of operations and makes it possible to reach out to those customers who have been left out until now.

> "Product diversification, rating agencies with Islamic microfinance expertise and Islamic microfinance investment vehicles are still missing to take the sector to the next level"

In Kenya, M-Pesa has created a revolution through a mobile phone-based money transfer, financing and microfinancing service, launched in 2007 by Vodafone for Safaricom and Vodacom. It has since expanded to Afghanistan, South Africa, India, Romania and Albania. M-Pesa allows users to deposit, withdraw, transfer money and pay for goods and services easily with a basic mobile phone. Islamic crowdfunding platforms have also been pushing into the informal space that previously was occupied by microfinance institutions, while also making it challenging for other incumbents such as banks to gain market share by downscaling into the microfinance market.

At the same time, the refugee crisis has put new demands on the microfinance industry to cater to a different clientele – small entrepreneurs who find themselves stranded penniless and are looking for ways to rebuild their business. But of the approximately 20 million refugees worldwide, only a small percentage have access to financial services. Moreover, the vast majority of the global refugees hail from the Muslim-majority countries of Afghanistan, Somalia and Syria and are also hosted again in neighboring Muslim-majority countries. Unfortunately, the very few services on offer are not Shariah compliant.

In the conventional sector, as a break from the norm, the United Nations High Commissioner for Refugees (UNHCR) has also launched a credit guarantee facility for microfinance providers specifically working with refugees. Another exciting innovation in the response to humanitarian disasters has been the use of cash instead of relief goods. Such cash transfer programs obviously differ from microfinance in that recipients are not expected to repay, and the financial services provided are not expected to continue in the long term but they are underlining the importance of access to finance, one of the targets of the UN Sustainable Development Goals.

Regulatory change has also taken place in, for example, Pakistan, with the Securities and Exchange Commission revamping microlending with all financial services providers, if not already microbanks, now requiring a license to operate as non-banking microfinance companies.

Preview for 2018

Islamic microfinance has not yet been affected extensively by the fintech revolution but it is only a matter of time when Islamic microfinance institutions will have to ask whether they can compete with peer-to-peer lending platforms and whether they can do it better. For the near future, we should be seeing more fintech start-ups entering the micro market, particularly to take advantage of the relatively low entry thresholds as well as in terms of regulation.

The growth of Islamic retail banking and Takaful operators is also likely to positively impact on microfinance as it is at that level where the unbanked are becoming financially included and hence potential customers. Islamic banks are likely, in their search for market share, to also down-scale or invest in microfinance institutions to do the work for them.

Yet a major concern remains the lack of product standardization especially for Qard Hasan, on which the Islamic microfinance industry relies heavily on. The current AAOIFI product standard was drawn up with commercial banks in mind which have a suite of revenue-generating financial services. But for microfinance institutions which serve poor and vulnerable customers perhaps solely through Qard Hasan, full cost-recovery opens up Shariah non-compliance risks under the current AAOIFI interpretation. This is an urgent concern that the standard-setting body will have to address to support the growth of the industry.

Conclusion

Islamic microfinance growth remains strong and fintech and competition from Islamic retail banks are likely to accelerate the speed further, although the shape of the industry is likely to move away from the traditional outreach service delivery to mobile microbanking. But product diversification, rating agencies with Islamic microfinance expertise and Islamic microfinance investment vehicles are still missing to take the sector to the next level.

Opportunities for Islamic treasury via technology and innovation

Aziz-Ur-Rehman Zia is the vice-president and head of structured investment products at Dubai Islamic Bank, Dubai. He can be contacted at azizzia@yahoo.com.

The more things change, the more they stay the same … or so we thought. What transpired in the past year has surpassed the wildest of imaginations, what a year! We witnessed events of great significance which have altered the global socioeconomic and political direction. The west has shifted to the right-wing political influence and eastern powers are emerging to fill the vacuum. Major dynamic shifts are occurring in the world and all institutions are affected due to the changing global economic conditions, including lower oil prices and lower government spending. In the Middle East in particular, the regional instability was a unique factor that has influenced economic activity this year.

Review of 2017

2017 has been a tough year with numerous hurricanes, both in physical and geopolitical terms. As the world at large continues to come to grips with the new reality, the Islamic finance industry has adjusted to more cost-focused strategies to cope with the new market conditions. The US$2 trillion Islamic finance industry continued to gather market share albeit with a slower growth rate. According to the Global Islamic Finance Report 2017, the growth rate of the Islamic finance industry in 2016 was 7% with a size of US$2.29 trillion. This year, the size of Islamic assets is likely to see a boost with sovereign Sukuk issuances. Islamic treasury activity continued to hold its own this year despite the challenges.

> “The Islamic treasury sector has a lot to look forward to in terms of playing its role in the transformation of the region; but at the same time it must overcome the technological challenges and use fintech innovations to its advantage to stay competitive in the future”

It is interesting to note that some institutions were cautiously upbeat in the beginning of the year with their growth projections but around mid-2017, the reality had sunk in profoundly; with the sustained low oil prices, lower government spending and higher borrowing, the Middle Eastern financial sector remained particularly under pressure with liquidity issues. The market at large was also of no help in to the financial industry – there was significant pressure on businesses and the mood in the SME industry in particular remained gloomy throughout the year.

Due to the lower liquidity situation, there was very little room for innovation in the market and as a result, no significant new products were introduced in the Islamic finance space. The harsh conditions reared its ugly head in the form of lower trading volumes and lower profitability compared with previous years and a headcount reduction in the finance industry.

One factor that remained in favor of money managers was the sustained low-interest rate environment with US rate hikes coming as anticipated. The lower international cost of funding has helped the financial sector in general but most significant flows have been diverted toward equity markets around the world which have continued to rally unabated. It would be fair to acknowledge that the situation has been handled well so far by the Islamic treasury sector as Islamic financial markets remain relatively calm and no major bankruptcies were observed so far in 2017.

The Islamic treasury sector has also braved other challenges that are common to the global finance industry, including the relentless push for technology which is both a bane and boon to the industry. On one hand, technology helps financial institutions to become more efficient but on the other, the constant innovation in fintech is also raising both competition and risks in the financial sector.

> “Government-led initiatives in the region are expected to help shift the dependence on oil and transform the region into a leading global hub of economic activity going forward”

It is healthy for customers to have options but sudden uncontrolled shifts could hurt the interest of the public at large. With the popularity of blockchain technology in the form of cryptocurrencies like bitcoin and Ethereum, there is increased pressure on the traditional financial industry to innovate and it is falling behind fast; the Islamic finance industry, even more so. This phenomenon is particularly worrisome as there is no objective benchmark to value the cryptocurrencies and with mind-boggling returns, the cryptocurrencies are drawing investors’ attention. Competition is deemed healthy but bubbles are dangerous. While there is a definite risk for cryptocurrencies to face a fallout with global regulators very soon, blockchain technology itself can be put to good use by banks and governments as a way to adopt, legalize and regulate the inevitable advance of cryptocurrencies. Estonia (Estcoin) and more recently Dubai (emCash) and Japanese banks (J-coin) have also announced venturing into the cryptocurrency realm. It is only a matter of time before this more efficient form of money becomes mainstream. This provides an opportunity for Islamic institutions, particularly the Islamic treasury sector, to gain the first-mover advantage and bring innovation to the Islamic marketplace.

Preview of 2018

As we look forward toward 2018, there are more challenges on the way with a higher cost of funds from the expected US rate hikes, more regulatory pressures in the form of the implementation of value-added tax and the IFRS9 coming into force; the cost of business for the financial sector will increase. Inflation is also expected to be higher in the region. It is safe to assume that the strategic game plan for the Islamic treasury sector shall be to play defense in 2018.

On the brighter side however, it is expected that there shall be more global Middle Eastern sovereign Sukuk issuances and further down the line, the planned IPO of Saudi Aramco is expected to free up liquidity for the Middle Eastern markets. The oil price is also expected to be higher going forward and should contribute to the better petrodollar inflows into the Middle East.

There are also a number of government-led initiatives in the GCC region such as Expo 2020 in the UAE, the Saudi Vision 2030 and the Saudi policy shift to modernize many aspects of the economy that should provide better stimulus for the region in the near future. There is also room to accommodate a better business environment in the region through the introduction of bankruptcy laws that would allow room for businesses to renegotiate loan terms and restructure their activities. This would help to provide more resilience to the Middle Eastern economy.

The Middle Eastern region already has one of the best infrastructures for stimulating economic activity and the planned transformation of the Saudi economy away from oil should prove to be a breath of fresh air for the region with increased economic activity and new avenues for global investors to benefit from the opportunities in the region. The Islamic treasury sector has a lot to look forward to in terms of playing its role in the transformation of the region; but at the same time it must overcome the technological challenges and use fintech innovations to its advantage to stay competitive in the future.

Conclusion

The Islamic treasury sector has experienced tough times recently with the uncertain political conditions, lower oil prices, low government spending, increased borrowing pressure and slower overall economic conditions. The pain is likely to sustain in the near future as business costs are likely to increase due to regulatory changes and a higher rate environment in 2018. However, it is hoped that global primary market activity in the region’s sovereign Sukuk space and the distant IPO of Aramco will attract fresh investment into the region. Oil revenues are also expected to increase as the crude oil price adjusts higher in the near future.

More importantly, the government-led initiatives in the region are expected to help shift the dependence on oil and transform the region into a leading global hub of economic activity going forward. This is where the real opportunity lies for the Islamic treasury sector in preparing to lead the new economic model via a technological edge and innovation in the way of conducting business.

Any public opinion or media appearance is the author’s independent personal opinion and should not be construed to represent any institution with whom the author is affiliated.

Global Islamic finance holds steady in uncertain times

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The IFSB reported in its annual report that the global Islamic financial services industry continued to slow down in 2016. Despite this, it reported that the industry had assets of approximately US$1.9 trillion, a similar value to the previous year. Significant regulatory advances in 2017 and planned developments next year could lead to an increase in Shariah compliant activity throughout 2018 and beyond, although the impact of challenges such as Brexit and the Dana Gas dispute remains to be seen.

Review of 2017

The UK government invoked Article 50 of the Treaty on European Union in March and Brexit negotiations are underway. The impact of Brexit on the UK's dominant position in Islamic finance is unknown, although commentators have pointed out that challengers such as Luxembourg have a long way to go if they are to compete with the UK's hold on the market. The pound sterling has still not recovered since the result of the referendum in June 2016 which has been good news for investors in the still-attractive UK market.

In terms of regulation, Kenya finally signed its Finance Bill 2017 into law in June. Among other things, the bill removes stamp duty on Shariah compliant products including Sukuk, leading to cheaper Islamic finance products for Kenyan investors and businesses. In addition, the Stamp Duty Act will come into effect on the 1st January 2018, under which stamp duty will only be charged on the initial transfer of property ownership, removing the obligation to pay stamp duty twice in some asset-backed Shariah transactions. This regulatory reform may lead to a rise in Shariah compliant activity in Kenya, and we may see the Kenyan government issuing Sukuk in 2018.

In September, the Financial Services Authority of Indonesia, or known as Otoritas Jasa Keuangan, published draft guidelines on the liquidation and insolvency of insurance operators, Takaful companies, reinsurers and re-Takaful operators, a market that is well established in the country.

AAOIFI, which has more than 200 members from 45 countries, has to date issued 99 standards covering a range of Islamic financial transactions and products. In February, it launched a Shariah standards e-learning platform in a bid for its standards to be accessible to a wider audience. At the time of launching the 99th standard (on Murabahah and other deferred payment sales) in September, the chairman of the AAOIFI Accounting Board emphasized the organization's plans to issue more standards in 2017, with the final meeting of the year due to be held in December.

Preview of 2018

Looking ahead, the Astana International Financial Center (AIFC), a financial free zone to be located in Astana, Kazakhstan, is planned to open at the beginning of 2018. It is hoped that the AIFC will act as a financial hub for countries throughout Asia, the Middle East and Europe. The AIFC has already led to closer collaboration between Kazakhstan and Malaysia which announced in May that a special committee will be set up between the two jurisdictions to promote

economic cooperation, focusing on areas such as Islamic finance and Halal development.

Meanwhile, the Dana Gas proceedings, involving a US$700 million global Sukuk facility which Dana Gas claims is no longer Shariah compliant, reached London's High Court in September. The proceedings were, however, adjourned until the 12th October 2017 after some of Dana Gas's shareholders obtained an injunction from a UAE court preventing some parties from taking part, leading to one of the prosecutors in the case accusing the energy company of "deliberately frustrating" the process.

UK High Court Judge George Leggatt on the 13th November 2017 said that he will issue judgment on Dana Gas's case soon and will not further adjourn the trial. At the time of writing, no judgment had been made yet. The outcome of the dispute is eagerly awaited — this is one of the first Shariah-structured transactions to be heard in an English court and investors are concerned that a ruling in favor of Dana Gas could pave the way for other issuers of Sukuk to seek to re-issue their bonds on less favorable terms.

It is hoped that global Shariah compliant activity will increase through 2018, when the impact of developments such as the AIFC and new regulations in Kenya, aimed at making Islamic transactions easier to carry out, will be seen.

Conclusion

In an unpredictable environment, the global Islamic finance industry remains steady. The significant regulatory advances that have taken place in 2017 should have a positive impact on the industry moving forward. Coupled with the planned developments across the globe and the widely anticipated outcome of the Dana Gas case, 2018 will prove to be an interesting year as the impact of 2017's developments continue to unfold.

Islamic liquidity management issue is not as simple as it sounds

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The liquidity management capacity of Islamic financial institutions, and more importantly of Islamic banks, has multidimensional implications on these institutions' performance and financial soundness. For conventional banks, liquidity management comparatively is more of a tool to efficiently utilize residual surplus funds as the industry's depth and scale of operations have reached a level where lending and investing activities have been available all across domestic as well as international markets.

The conventional financial sector has at its disposal a number of innovative and diversified avenues to place funds in a profitable and timely manner. Islamic financial institutions are not able to achieve this level due to the following: (a) the industry is still young and not mature, (b) a lack of consensus among Shariah scholars on liquidity management solutions even in a single jurisdiction, (c) the non-availability of a lender of last resort (LoLR) facility in general and (d) the non-standardization of Shariah rulings, laws and regulations across jurisdictions. All of these are discouraging the Islamic financial industry from going big on an international scale.

> "The lack of active liquidity management has taken its toll on the profitability of the Islamic banking sector and plays a big part in increasing the probability of displaced commercial risk occurring"

Review of 2017

Investment in Sukuk, international commodity Murabahah and central banks' instruments to absorb Islamic banks' liquidity remain the major avenues of managing liquidity. The industry is mainly counting on the development of the Sukuk market as a solution to its liquidity management problems. Although 2017 has been a good year for Sukuk issuances led by Saudi Arabia, Indonesia, Oman, Hong Kong, Malaysia and such, the Sukuk inventory in the domestic and international markets is still not enough to absorb the liquidity available from Islamic banks let alone other Islamic financial institutions.

In the present domestic and international economic and business scenarios, the absence of effective and common liquidity management tools for Islamic financial institutions and specifically for Islamic banks is not just a matter of enhancing profitability but also a continuing challenge to demonstrating their financial soundness and resilience in times of funding stress. This has gained further importance in the backdrop of Basel III implementation in jurisdictions where Islamic banks have a significant presence and operations.

In some jurisdictions, Islamic banks rely on a given jurisdiction's central bank for obtaining liquidity in times of stress not only in their individual capacity but as an industry in general. This is reflected in their maturity mismatch profile which at times portrays high negative mismatches between assets and liabilities mainly in the shorter-than-one-year time frame. This reliance keeps a central bank under constant stress, ie its ability and financial strength to support the banking sector and this inevitably also brings in the financial commitments of the relevant sovereign. One of the causes of this passive liquidity management is the non-availability of liquid and tradeable Islamic financial instruments.

In most of the jurisdictions, the given jurisdiction's sovereign is the originator of Sukuk issuance while the corporate sector is almost inactive or has issued little Sukuk. The sovereign Sukuk supply side has not been up to the scale that can meet the investment needs of Islamic banks and other Islamic financial institutions. Furthermore, the supply of Sukuk with short-term tenors is also very limited leaving Islamic financial institutions to wonder about what to do with the liquidity on their hands. In some cases where Islamic banks make use of their limited Sukuk portfolio to package them as a product to use for interbank market operations, the risk of foregoing their good-quality Sukuk discourages Islamic banks from actively pursuing this mechanism when the counterparty does not have the same quality Sukuk that have to be replaced with good quality Sukuk when executing the deal.

In some jurisdictions, liquidity management is not a function of residual funds but rather an upfront issue to deal with, right from the time a deposit is accepted by an Islamic bank, as the structure and the size of the economy is small and the corporate and industrial bases are not that developed to absorb funds available from banks, be they Islamic or conventional banks. Banks in such jurisdictions have been raising deposits aggressively in foreign currencies from abroad and partially placing them with central banks which maintain or offer an attractive profit rate to encourage foreign currency deposit mobilization in the home jurisdiction. Liquidity management in such a scenario takes a backseat and there is no urgency to develop an interbank market or liquidity management tools.

An LoLR window facility is not available in some jurisdictions; however, in some jurisdictions, central banks are working on such a facility for Islamic banks.

Preview of 2018

The expected availability of liquidity management products from international platforms such as the Bank of England and new Sukuk issuances by sovereigns and financial institutions can provide more options to Islamic banks but they would not be sufficient to meet the industry's needs. Islamic banks and Islamic financial institutions are required to extract the maximum out of possible options, including extending the frontiers of permissibility by the adoption of financial technology (fintech).

Firstly, the industry, regulators and standard-setting bodies should decide what to do with unrestricted investment accounts (URIA), ie whether they should be treated like guaranteed deposits as in the case of conventional banks, hybrids or fully profit and loss-sharing stakeholders. This clarity across jurisdictions will help to align Islamic banks' financially sound footing and refine their approach in liquidity management strategies to enable each bank to know exactly what they are doing and what maturity profile they are required to manage. In this context, one has to be mindful that this cannot be decided only by central banks, standard-setting bodies and Islamic banks as the inclusion of depositors of Islamic banks for this purpose is of great significance.

Depositors, including the general public and corporates, must knowingly and willingly agree to the features of a URIA account with the clear disclosure of what can happen to their money if the bank suffers a loss or fails. This litmus test will define risk parameters and the profile of an Islamic bank for prudential and regulatory purposes without drawing and re-drawing lines between risk and return trade-offs to capture their risk profiles by banks, regulators and standard-setters across all jurisdictions.

Islamic banks can also consider packaging some proportion of their financing portfolio into a Sukuk form. The financing can be packaged, depending on the nature of the underlying features, as Murabahah, Musharakah, Ijarah or other permissible forms. The structures and process that can enable such a packaging are available and, subject to Shariah clearance, can be adopted.

> "Brand or franchise value alone is not sufficient to run Islamic financial institutions"

Further, new technological developments such as fintech can be helpful in addressing issues raised by Shariah scholars pertaining to the timing and execution of steps relating to certain liquidity products. Again, products are available that can become Shariah compliant with the use of fintech in a cost-efficient manner.

An LoLR facility can be worked out on a guarantor-beneficiary relationship basis. Product structures can be made available with a similar prudential mechanism that provides efficiency and execution ease as that used by central banks for the conventional counterparts of Islamic banks.

Last but not the least, Sukuk issuances with short to long-term tenors have to be a regular feature where exchange listings with a minimal possible cost, minimal criteria and a shorter time to list, among other factors, would encourage issuers to go for Sukuk issuances as an active option compared to bank financing. The Dubai Multi Commodities Center can also be leveraged for this purpose.

Conclusion

In a nutshell, the lack of active liquidity management has taken its toll on the profitability of the Islamic banking sector and plays a big part in increasing the probability of displaced commercial risk occurring, which in part forces Islamic banks to run the reputational risk. The liquidity coverage ratio is going to pose a constant pressure on Islamic banks to remain compliant which will be an uphill task in the absence of high-quality liquid assets. It is important to realize that brand or franchise value alone is not sufficient to run Islamic financial institutions, rather this should be an affair conducted mainly on a successful commercial basis so that sponsors, shareholders and deposit holders can earn their due return and be more than willing to put more money for the expansion of the industry.

Islamic banks' financial performance and its effect on mergers and acquisitions

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As projected by S&P Global Ratings, the Islamic finance industry in general is expected to lose its growth momentum although it may still continue its expansion in 2018. The fluctuations of oil prices directly affect the Islamic finance sector since it mainly depends on the oil-exporting countries' transactions, with the GCC, Malaysia and Iran creating 80% of the sector's total assets. While oil prices are decreasing, governments have chosen to cut their investment and current spending resulting in a reduction of Islamic finance's growth prospects.

In terms of mergers and acquisitions (M&A) in the Islamic finance sector, it is expected to show a parallel performance with the Islamic finance industry's overall trend. Even consolidation could be a way forward in a number of GCC markets as projections show that the M&A transaction value and numbers may not be satisfactory within 2018.

Review of 2017

Latest figures show that M&A transactions have decreased in terms of value and number in 2017. The total number of M&A transactions carried out within the period of the first half of 2017 (H1 2017) clearly indicated that the decrease in performance was expected to continue until the end of the year. In terms of M&A deal numbers within the MENA region during H1 2017, 192 M&A transactions were recorded, indicating a decline of 23.2% when compared with 250 deals in the same period of 2016. When it comes to the transaction value recorded within the first nine months of 2017, deals with any Middle Eastern involvement also decreased by 5.88% to US$35.2 billion from US$37.4 billion. The most remarkable deal of 2017 was AWAS Aviation Capital's acquisition by Dubai Aerospace Enterprise in return for US$7.5 billion which was recorded as the largest transaction so far.

Phil Gandier, the MENA Transaction Advisory Services leader at EY, had commented on the deal numbers and value, saying: "In the first half of 2017, 61% of the acquisition capital was allocated outside MENA, making MENA a net exporter of capital. We expect this trend to continue for the remainder of the year as investors continue to see more value and lower risk in non-MENA markets."

Regarding Islamic banks' performance within the GCC countries, the slowdown continued in 2017 following the decline in asset growth to 5.3% in 2016 from 10.7% in 2014. According to S&P, it is expected to have a growth rate at around 5% due to the governments' actions such as spending cuts and revenue-boosting initiatives such as new taxes, reducing Islamic banks' growth opportunities in corporate and retail sectors.

To sum up, although 2017 was projected to be a successful year with the M&A boom expected to carry on after the first months of the year in spite of political and economic uncertainties, it has not turned out as projected at the beginning.

Preview of 2018

In terms of expectations for 2018, unlike 2017, the following 12 months may have less political uncertainties without significant elections or developments such as the US presidential election or

Brexit's global effects on world economies. However, it is also worth noting that 2018 may bring a number of new challenges such as US President Donald Trump's unexpected decisions or rising political tensions such as the North Korea crisis. Although investors may consider that there is continued instability for the M&A market amid economic and political uncertainties, the optimism of investors will continue for 2018 and they may seek transactions which can be considered tactical corporate deals. The global M&A transactions currently show that the major M&A deals are still dominated by strategic buyers rather than financial investors.

A note by S&P stated that the poor economic environment will continue to negatively affect the financial performance of Islamic banks in GCC countries during 2018. "We foresee further declines in GCC banks' asset quality and profitability indicators in 2017-18," said S&P's head of Islamic finance, Dr Mohamed Damak. "Still, we think that the banks have built sufficient buffers to make the overall impact on their financial profiles manageable." The performance of the Islamic banks is an important indicator especially for Islamic M&A activities.

Conclusion

The financing of Islamic M&A deals through Islamic banks may directly affect the transactions and vice versa. Therefore, it is important to follow Islamic finance institutions and M&A players to understand the performance of both M&A and Islamic finance within the next 12 months. Islamic M&A deals are part of the Islamic finance industry; however, if they are considered as two different sectors, they mutually contribute to each other's development around the world.

Islamic finance institutions' competition with the conventional banks is also a significant area which has an effect on M&A activities. Therefore, Islamic banks may seek to create more competitive financial institutions through M&A and support Islamic M&A deals in the following years.

Islamic project and infrastructure finance: State of the market

Shibeer Ahmed *is a partner and head of Islamic finance at Winston & Strawn. He can be contacted at sahmed@winston.com.*

Approximately US$71 trillion is required globally by 2030, according to the OECD, to fund infrastructure projects, including road, rail, telecommunication, power and water infrastructure. A significant proportion of these projects will require private sector financing and, therefore, offer opportunities for Islamic investors and financial institutions globally. While the current economic climate, including low oil prices, has had an impact on the implementation of infrastructure projects, most governments have endeavored to maintain their commitment to infrastructure development. This has led to greater incentive for many governments to tap into private sector financing, including through Islamic project finance (IPF), to develop large-scale infrastructure projects.

Review of 2017

In recent years, most large-scale projects, particularly in the GCC, have featured one or more Islamic tranches alongside conventional debt financing. The most frequently used IPF structures have been based on Istisnah-Ijarah and, in some cases in Saudi Arabia, Wakalah-Ijarah structures. This has been particularly the case for power, petrochemical and industrial projects, such as the US$20 billion Sadara petrochemical complex, the US$2.5 billion Shuaibah independent water and power project and Phase II of the US$10.2 billion Emirates Aluminium smelter project.

The pipeline of infrastructure projects funded through IPF this year has not been as robust as previous years. There is, however, a wider understanding that IPF offers a genuine means of deepening the available capital pool to fund infrastructure projects by including one or more Islamic tranches in a multi-sourced financing structure. While the use of IPF in multi-sourced project financing arrangements inevitably leads to inter-creditor issues between Islamic finance providers, conventional banks, export credit agencies and/or multilateral organizations, the success of various Islamic project financings in recent years has demonstrated that such issues can be overcome. As the IPF sector develops, the proportion of project financings which include one or more Islamic tranches and the size of such tranches are expected to increase.

The projects recently financed through IPF alongside conventional financing sources include the AED1.2 billion (US$326.64 million) 200 MW Phase II of the Mohammed bin Rashid Al Maktoum Solar Park in Dubai which reached completion in March this year, the RM339 million (US$81.07 million) 50 MW solar project in Selangor (Malaysia) which reached financial close in August 2017 and the 800 MW Phase III of the Mohammed bin Rashid Al Maktoum Solar Park in Dubai which reached financial close in June this year. Further, there has been an increasing focus on the Islamic financing of infrastructure projects in Africa, as highlighted by the recent commitment of the IDB to provide US$805 million of financing for infrastructure projects in a number of African and Latin American countries.

Islamic finance has largely been an untapped source of financing for public-private partnership (PPP) projects and traditionally IPF has not been considered as a source of financing for PPP projects (where the project company does not have an ownership interest in the underlying project assets). This has elicited much interest from governments and development banks to mobilize IPF for PPP

infrastructure projects, particularly as recent structures that allow concession rights granted to the project company to be used for the purposes of the financing arrangements have rendered IPF a viable financing option for such projects. According to MEED, approximately 151 PPP infrastructure projects, with a total value of approximately US$185 billion, are currently planned or underway in the Middle East and Africa, which could offer ample opportunities for the use of IPF to fund PPP projects.

Preview of 2018

According to S&P Global Ratings, the Islamic finance industry will continue to expand in 2017 but lose some momentum in 2018 and it is "unlikely that some of the large transactions seen in the first half of the year will be repeated in 2018". It may, however, be too early to determine whether this expectation will hold true specifically for the IPF sector given the pipeline of infrastructure projects in the Middle East, Asia and Africa (including the pipeline of infrastructure projects in Saudi Arabia as part of its 2030 Vision) for which IPF could offer a viable financing option alongside conventional modes of financing.
However, questions remain whether Islamic financial institutions have the requisite capital base and flexibility to meet the increasing demand for larger and more numerous Islamic tranches in multi-sourced financings and, more determinatively for the sector, to independently fund large-scale projects. In order to ensure the sustained development of the sector, reconsideration and adaptation of existing IPF structures to meet the current and developing needs of the project finance sector and the enhanced regulation of the IPF sector will continue to be desired from governments, regulators and other stakeholders.

Conclusion

Although the pipeline of infrastructure projects funded through IPF in 2017 has not been as robust as in previous years, the future for IPF looks promising and its continued development is a testament to its suitability for financing development projects. In particular, the availability of IPF structures for financing PPP projects demonstrates the versatility of IPF and marks a further stride toward establishing IPF more firmly as a viable source of financing alongside conventional financing sources for infrastructure development projects.

Islamic banks to remain stable although not immune to adverse economic developments

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Profitability at Islamic banks in the GCC has historically lagged that of conventional banks due to higher operating costs and more extensive loan losses, but this trend has now reversed. Islamic banks outperformed conventional lenders in 2016-17 as their margins strengthened and their financing quality improved. Moody's Investors Service's comparative analysis in this report includes 19 fully-fledged Islamic banks (17 of which are rated) and 38 conventional banks (37 of which are rated) in the GCC.

The Islamic windows of conventional banks were not segregated from the performance of conventional banks. Together, Islamic banks accounted for total assets in excess of US$430 billion as at the end of 2016, against US$1.48 trillion for conventional banks. Moody's expects this trend to continue into 2018. The stronger performance of Islamic banks has been reflected in recent credit rating affirmations and upgrades by Moody's for some Islamic issuers in the Gulf region.

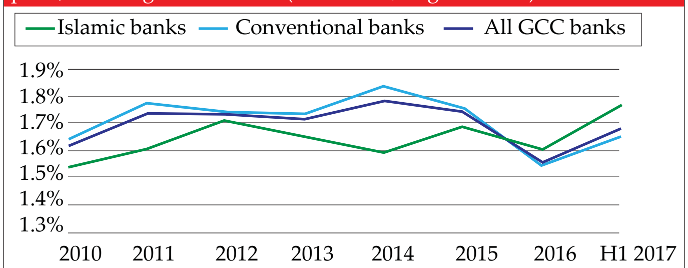
Review of 2017

Oil price weakness slowed economic growth in the GCC last year, resulting in lower credit demand and tightened liquidity which strained banks' profits. The banks faced higher funding costs, both on deposits and market borrowings, which led to narrower margins, while their provisioning charges rose as borrowers came under pressure in a weakened economy. Despite a rebound during the first half of 2017, the net profitability of GCC banks as a whole remains below levels enjoyed before the oil price slump in 2014.

Islamic banks broadly reflected the same trends, but they were able to report higher profits than in pre-crisis years. In Moody's view, this was mainly because they have a higher proportion of low-cost customer deposits, which kept their funding costs low and supported their margins, but it was also due to improved financing performance and better risk management, which reduced their financing-loss provisioning needs. We expect these trends to continue, and that, as a result, Islamic banks' net profitability will surpass that of their conventional peers for a second consecutive year in 2017 (see Chart 1).

Islamic banks' large volumes of stable and low-cost current and savings accounts (CASA) are a credit strength. CASA balances represent around 50% of their total deposit base as of June 2017. This is largely driven by a large base of retail customers, who attach high importance to Islamic banks' ethical investment principles. As well as stronger retail franchises, Islamic banks have extensive real estate lending franchises, which typically generate higher yields, and have consistently given them stronger margins than their conventional peers (see Chart 2).

Chart 1: Islamic banks to maintain higher profitability than conventional peers, reversing 2010-15 trend (net income/tangible assets)



Source: Banks' financial statements; Moody's Investors Service

"The improvement in net profit margins will vary by bank; however, Islamic banks with the highest proportion of corporate financings (which are easier to re-price when interest rates rise owing to their floating rates) and with the highest proportion of CASA balances are likely to benefit the most"

Despite strong core earnings, weak efficiency has long weighed on Islamic banks' net profitability. The cost-to-income ratio of Islamic banks has historically hovered around 40% since 2010, compared to around 35% for their conventional peers. This is because they are younger and more focused on retail customers, entailing higher levels of investment in branch networks and in technology.

Higher impairment charges on financings and investments have also historically dampened Islamic banks' profitability. Previously, a high proportion of these charges were driven by their greater appetite for investing in the volatile real estate sector, seen as closer to Shariah principles due to the tangibility of property assets. Additionally, in Moody's opinion, a lack of appropriate risk management practices led to higher financing losses. Financing-loss provisioning needs at Islamic banks have fallen significantly in recent years however.

Diversification away from real estate lending toward other sectors has helped and so has improved risk management. Consequently, provisioning is now lower than at conventional banks.

Preview of 2018

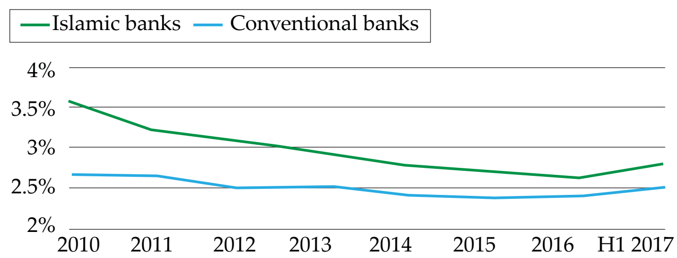
Moody's expects Islamic banks to continue to outperform conventional peers in 2018 as rising interest rates translate into higher margins.

> A bank's performance is closely related to macroeconomic factors

We expect a further increase in US rates will push up interest rates in GCC countries owing to the local currencies' peg to the US dollar and thus will drive up asset yields. Conventional banks will likely see their funding costs increase more than Islamic banks. This is because Islamic banks' higher proportion of CASA will keep their costs relatively stable. As a result, Islamic banks should be able to expand their net profit margins as interest rates rise. The improvement in net profit margins will vary by bank; however, Islamic banks with the highest proportion of corporate financings (which are easier to re-price when interest rates rise owing to their floating rates) and with the highest proportion of CASA balances are likely to benefit the most.

We have recognized these improvements in the profitability and broader risk profile of GCC Islamic banks in recent rating actions. Moody's applies the same methodology to assign bank ratings, irrespective of the bank type, Islamic or conventional. In the last

Chart 2: Islamic banks maintain stronger margins (net interest margin)



Source: Banks' financial statements; Moody's Investors Service

24 months, Moody's has (i) upgraded the ratings of Dubai Islamic Bank, Boubyan Bank and Masraf Al Rayan; (ii) upgraded the stand-alone baseline credit assessment of Abu Dhabi Islamic Bank; and (iii) affirmed the ratings of the largest Islamic bank in the world, Saudi Arabia-based Al Rajhi Bank, at a time when other bank ratings in the GCC were downgraded because economic headwinds were pressuring their stand-alone risk profiles.

Conclusion

Our expectations are broadly stable for Islamic banks in the region. However, the banks are not immune from adverse economic developments. Moody's believes that a bank's performance is closely related to macroeconomic factors, and, as such, the deteriorating operating environment in some GCC countries such as Qatar, Bahrain and Oman, where our outlooks on the sovereign ratings and banking systems are negative, will pressure the credit profile of domestic banks over the next 12-18 months, irrespective of whether they are Islamic or conventional. Nevertheless, we believe that rising interest rates and improved cost of risk will support their outperformance over the coming quarters.

The growing influence of REITs

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The allure of real estate for Islamic investors remains strong. While equities and Sukuk will always be a significant part of a Shariah compliant investment portfolio, there is something about the bricks and mortar of real estate that appeals.

While tenant use of course needs to be monitored, the basics of real estate investment suit Shariah principles well, with a genuine business being undertaken, either to build and let or sell new property or hold existing properties for their rental income.

As they say: "Necessity is the mother of invention." So broadly speaking, where Islamic investors want to buy real estate, there is now the necessary critical mass of professionals able to assist. What is still lacking is a scale to Islamic banks outside of the Middle East and Southeast Asia able to provide Shariah compliant finance for larger transactions, with conventional finance and a structure to insulate investors from the non-compliant payment of interest required in a pragmatic approach to allowing transactions to occur.

Review of 2017

Within the western world, 2017 saw the first impact from Donald Trump and Brexit. With a few exceptions, neither event dissuaded the majority of investors to seek new opportunities in the US and the UK, while Germany would have attracted even more capital if the market wasn't so competitive. Outside of these markets, the Netherlands, the Nordic region and Australia remained popular, with some activity in southern Europe and beyond.

Individual transactions rather than funds continued to dominate, but there is a growing voice toward such funds that hasn't been heard for more than 10 years. Risk aversion remains key, with income-producing assets vastly preferred, although investors have had to learn to live with a slightly lower net cash yield than previous years as asset prices and finance costs rose, and the ability to make tax deductions continued to diminish.

The big news within the Middle East was the success of Saudi Arabia's new REIT market, with the vast majority of listings being Islamic. With an understandable focus on domestic properties, although 25% of each REIT can be overseas properties, legislation passed at the end of 2016 has led to at least five REITs being listed and trading well. An additional 30 are in the pipeline. This is an enormous success, not least from opening up Shariah compliant real estate investment to an even wider investor base.

Islamic real estate was not immune from the positive influence of fintech, with a number of crowdfunding initiatives being launched or growing to more substantial levels, as well as more innovative ways to finance acquisition of homes. Such innovation is to be applauded and I'm sure will go from strength to strength.

Preview of 2018

With REITs, particularly those out of Saudi Arabia being the big news story of 2017, I suspect that funds may more widely be grabbing the headlines in 2018. Investor sentiment seems to be warming toward it, with the benefits of diversification and even some appetite for blind funds where assets have not been identified in advance, at least where the investment manager can show previous competence in a specific sector. Talk of global diversified funds is even starting to build, which would be very exciting.

With respect to the real estate markets themselves, pauses or even falls in value for certain sectors were blamed on political factors in 2017 such as unexpected election results or the UK's Brexit referendum, when in truth these sectors were due to at least slow down anyway. Focus on demand versus supply fundamentals and relative value should remain paramount during 2018.

"Further changes to tax rules affecting Islamic and non-Islamic investors alike cannot be ruled out, but most investors and managers have already adopted conservative structuring and assumptions in this regard"

Risk aversion will not subside, but investors will continue to need to get used to lower net cash yields, unless they are willing to move up the risk spectrum. This may increase geographic diversification further as managers and investors seek less competitive markets where opportunities may reside.

Regrettably, I see little change in the size of Islamic bank balance sheets, which would otherwise allow direct Shariah compliant finance to be sourced on larger mainly commercial real estate investments. Talk of banks syndicating such facilities is increasing, and I hope that 2018 can see this grow. This would be both positive for the banks themselves and the wider Islamic finance industry.

Further changes to tax rules affecting Islamic and non-Islamic investors alike cannot be ruled out, but most investors and managers have already adopted conservative structuring and assumptions in this regard, so I don't see this having a major impact.

Conclusion

The attractions of real estate to Islamic investors will not diminish, and should the recent momentum of REIT activity be at least maintained and the talk of funds lead to positive action, 2018 could be a wonderful year for Shariah compliant real estate investment.

I can't wait.

Responsible finance brings rays of hope for 2018

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As 2016 concluded, the declaration in the responsible finance world was out: 2017 was to be the year of the sovereign green bond and the first such bonds were issued by Poland and France (responsible finance includes sustainable and responsible investment; Islamic finance; environmental, social and governance (ESG) investment and impact investment). After the 'firsts' were recorded, a diverse range of countries including many with large Muslim populations such as Nigeria, Kenya, Morocco and Jordan have been preparing their own sovereign green bonds.

Review of 2017

Green bonds are not the entire responsible finance market but fixed income capital markets have become headline-grabbing for responsible investment in many ways similar to how Sukuk have raised the profile for Islamic finance during the past 15 years. The diverse spread of countries mentioned in the green bond market signals growth in responsible finance beyond core (developed) markets into newer growth markets across the world.

Although the development of responsible finance is occurring in markets where Islamic finance has the greatest market share, it is still nascent in many of these markets. The UAE is home to the title of the first green (conventional) bond being issued for US$587 million by National Bank of Abu Dhabi (now First Abu Dhabi Bank). Malaysia became home to the first and second green Sukuk, with two project Sukuk issued to finance solar power installations and raising a combined RM1.25 billion (US$298.93 million).

Malaysia also continued work done earlier to establish responsible and Islamic finance together with the Employees Provident Fund (EPF) and Khazanah Nasional building on developments of the past few years. The EPF announced in 2016 that its announcements were aligned with ESG principles, and in 2017 announced that over RM59 billion (US$14.11 billion) has been allocated toward Shariah compliant (and ESG-aligned) investments. In 2018 and in subsequent years, the EPF expects this figure to grow by RM25 billion (US$5.98 billion) annually.

Elsewhere in the world, the European Commission (EC) announced the formation of a High Level Expert Group (HLEG) on Sustainable Finance which was charged with making recommendations about future policies that could accelerate the development of the sector. The recommendations made in the interim report focused on expanding the prevalence of ESG integration among investors and encouraging more investment in sustainable development including in the transition to a low-carbon economy.

Following on the EC's move, emerging market securities regulators working within the International Organization of Securities Commissions (IOSCO)'s Emerging Markets Committee established a sustainable finance task force of its own. In announcing the task force, the committee's vice-chairman, Ranjit Ajit Singh, who is also the chairman of Malaysia's Securities Commission, framed the development in terms of both his country's aspirations on Islamic finance and sustainable finance.

Malaysia's aspirations in Islamic and sustainable finance were boosted by the release of a strategy paper by Bank Negara Malaysia on values-based intermediation. The paper outlines how Islamic banks in Malaysia should approach the task of outlining their corporate value intent and then setting key performance indicators against which they will measure progress.

In a parallel development, the IDB has become more active in aligning its strategy with the UN Sustainable Development Goals (SDGs), especially on climate change adaptation and mitigation efforts which accounted for 16% of the bank's 2016 financing. In September, the bank's private sector arm, the Islamic Corporation for the Development of the Private Sector provided US$28.5 million in financing alongside the European Bank for Reconstruction and Development for a solar project in Egypt.

Preview of 2018

Although the investment outlook is often viewed in relation to the presence or absence of geopolitical and economic risks, of which there are many, there is significant cause for optimism in the responsible finance sector. A global consensus has emerged that makes the SDGs the defining metric for what sustainable economies look like.

The application of the SDGs to the financial sector and to business in general is a multiyear process, but in 2018 it will be driven forward by the conclusion of the EC's HLEG on Sustainable Finance, as well as IOSCO's work relating to sustainable finance emerging markets. In markets with significant Islamic finance industries, there remains a gap between global work on responsible investment (which focuses on capital markets) and the banking sector.

In addition to developments on value-based intermediation in Malaysia and Indonesia's Sustainable Finance Roadmap, every country's efforts to meet their nationally determined contributions will involve substantial involvement by the financial sector and in many countries, Islamic finance will have to become involved as well.

For both conventional and Islamic sustainable finance, fintech will play a role in supporting the achievement of the SDGs. Fintech can make existing financial sector activities more efficient and expand access to finance, including among populations that have been traditionally excluded.

Financial inclusion, however, is not among the SDGs on its own because finance should not be an end in and of itself. It is only useful for achieving the goals if it supports the SDGs, such as by providing financing to renewable, distributed and affordable energy sources. Fintech on its own can disrupt the financial sector but may need to develop stronger links with applications of technology in other contexts to have its full effect.

Conclusion

There are many opportunities for concern in the economy as well as the geopolitical situation of the world today but responsible finance offers a ray of hope with efforts coming from around the world using different approaches for similar objectives.

Regulatory encouragement for sustainable and Islamic finance, multilateral development bank support and a growing recognition by asset managers, asset owners and commercial and investment banks that responsible finance is the future have provided fuel for a shift in the financial sector.

In 2018 and beyond, new tools including fintech will enter the picture in a bigger way to drive a more fundamental shift and bring responsible finance into the mainstream.

Squeezed liquidity and geopolitical risk remain key themes for 2018

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With the return of growth, both conventional and Shariah asset classes performed well this year, as an acceleration in earnings momentum continued to anchor growth, with global benchmarks setting new highs in 2017.

> "Strong global growth and generally benign inflation in developed markets should still keep global risk appetite well supported"

Review of 2017

The year 2017 saw an economic upswing that lifted both global and regional markets in terms of growth and asset returns. Bonds and equities enjoyed a 'Goldilocks' moment this year, with market conditions appearing 'just right' for the time being with brisk growth and benign inflation.

A positive earnings revision cycle and strong fundamentals continue to anchor growth in the region, with Asia scoring top marks and appearing as one of the best performers this year. Asia's earnings per share (EPS) growth for 2017 has been revised upwards by 21%, eight percentage points higher than when we started the year, according to IBES, Thomson Datastream. Led by gains in the tech sector, it accounted for 47% of Asia's year-to-date returns so far, with Alibaba and Tencent pacing gains for the Dow Jones Islamic Asia Pacific ex-Japan Index. We expect earnings momentum to normalize going forward, looking at about 11% of EPS growth in 2018, as positive earnings revision may approach the end of the upgrade cycle as expectations catch up.

Table 1: S&P Global BMI sector performance (2017 year-to-date)

GIC sector	Return
Information technology	28.4%
Healthcare	17.5%
Industrials	17.1%
Materials	17%
Consumer discretionary	14.2%
Financials	13.6%
Utilities	12%
Consumer staples	9.4%
Real estate	9.1%
Telecom services	3%
Energy	-3.3%
S&P Global BMI	-14.8%

Source: S&P Dow Jones Indices. Data as of the 27th September, 2017. Calculations are based on price return index levels in US$.

Shifting the discussion closer to home, economic data showed that an export-led recovery is underway with a quick rebound in electrical and electronic exports, and a pick-up seen in Malaysia's manufacturing purchasing managers' index which has accelerated in tandem with the return of growth. Other economic indicators, including an increase in loan growth and applications, point to continued expansion which remained supportive of economic activity.

Shariah equities proved their resilience once again, with the S&P and Dow Jones Shariah compliant benchmarks outperforming their conventional counterparts year-to-date through the 27th September 2017. Information technology and healthcare stocks which tend to be overweight in Islamic indices led gains in the respective index. Both the Dow Jones Islamic Market World and S&P Global BMI Shariah Indices each gained more than 17% respectively for the year, outperforming the conventional S&P Global BMI by nearly 300bps.

We see the performance mirrored as well in the local stock market, with the FTSE Bursa Malaysia EMAS Shariah Index and the FTSE Bursa Malaysia EMAS Index notching similar returns of 5% compounded annually over five years. Performance was driven by manufacturing and technology stocks, as well as selective mid-sized construction stocks which paced gains in the Shariah index.

"Growth will be gradual as more innovative and structured instruments are introduced to the market, and hopefully they will emulate the success of their conventional counterparts"

Preview of 2018

So, what will markets herald for 2018? It seems broad geopolitical concerns are keeping global fund managers awake at night with the prospect of a long drawn-out conflict between the US and North Korea which threatens to escalate further (source: BofA Merrill Lynch Global Fund Manager Survey, September 2017). While it doesn't look like it would escalate to anything more than just mere sabre-rattling between the two leaders, what these recent developments point to is that investors can no longer afford to ignore geopolitical risks and the impact they have on markets.

On global monetary policy developments, we saw the US Federal Reserve finally pulling the trigger to begin the unwinding of its US$4.5 trillion balance sheet. The European Central Bank (ECB) has also indicated its stance to gradual monetary policy tightening, in light of stronger economic growth in the eurozone. How this gradual pull-back in liquidity will impact markets will have to be closely monitored but what's clear is that policymakers are signaling an end of a decade-long era of easy credit which kept the economy afloat post the global financial crisis.

While this gradual tightening could lead to a stronger US dollar and higher bond yields, as well as demand for more US dollar-denominated assets, we don't expect any sharp reversal of flows away from ringgit and emerging market bonds. Strong global growth and generally benign inflation in developed markets should still keep global risk appetite well supported. As such, global central banks

including the Fed, ECB and Bank of Japan will remain gradual in their monetary policy normalization for now due to benign inflation. Hence, the hunt for higher yielding assets such as emerging markets bonds or Sukuk should still remain in fashion for the moment.

We also expect reverberations from the Dana Gas dispute to drag on until 2018 and will certainly be closely-watched in the industry. Proceedings are underway, and though different arguments have been put forth, it certainly highlights the need for the harmonization of accepted Shariah standards and practices as the industry matures. AAOIFI is looking to revise its existing standard on Sukuk, with a final version expected in 2018, as reported by Reuters in June 2017.

Industry trends and regulatory developments

The local asset management industry received a boost from regulators with the release of the Securities Commission Malaysia (SC)'s five-year Islamic Fund and Wealth Management Blueprint which will reinvigorate growth and increase demand for Shariah compliant investments. Containing three strategic thrusts, the blueprint will focus on efforts to deepen and broaden the suite of Shariah compliant wealth management solutions across the value chain, while enhancing market infrastructure for players. Indeed, Malaysia is positioned strategically to lead the global Islamic fund industry, with total assets under management (AuM) of US$22.6 billion as at the first quarter of 2017, which is equivalent to 31.9% of the total global Islamic AuM, according to Thomson Reuters.

Conclusion

While we are seeing some evolution in product innovation, there is still a visible gap when it comes to Shariah compliant products, as we still see a lack of Shariah compliant structures being made available to the market. Thus, it makes it challenging for industry players to veer off from the plain vanilla type of funds.

Progress is certainly underway, with our regulators displaying the foresight to take Malaysia's Islamic capital market to greater heights. Growth will be gradual as more innovative and structured instruments are introduced to the market, and hopefully they will emulate the success of their conventional counterparts.

Sukuk: Slow and steady

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After a sharp downward correction in 2015 following a decision by the central bank of Malaysia to stop issuing Sukuk, the volume of Sukuk issuance in 2016 evidenced a slowdown in growth in the international Sukuk market. This slow growth came to a brief end in the first half of 2017, as we saw an increase in the total value of Sukuk issued during this period compared with the same period in 2016. This increase in issuance value may, however, prove to be an anomaly rather than a return to the rate of growth not seen in the market since the first half of this decade. Nevertheless, we are beginning to see positive signs of a return to stronger and more sustainable rates of growth for the coming years.

Review of 2017

The first half of 2017 saw an increase in the value of issued Sukuk of more than 37% (figures obtained from S&P) over the same period from the previous year. This, however, was primarily attributable to several large sovereign issuances which took place during this period. April 2017 saw the issuance of US$9 billion-worth of Sukuk by the Kingdom of Saudi Arabia, which was and remains one of the largest Sukuk issued globally to date. In addition, many other GCC governments also chose to tap the Sukuk markets during this period, including large GCC corporate issuers such as Saudi Aramco.

With regards to the development of the Sukuk market in terms of geographies, while the global Sukuk market continues to be dominated by Malaysia and the GCC, 2017 saw a significant rise in Sukuk issuance in Iran, which has started to open up economically following the lifting of certain economic sanctions in 2016. Another positive trend for the Sukuk market in 2017 is the continued narrowing of the pricing gap between Sukuk and conventional bonds. For most investment grade issuers, the choice between issuing conventional debt versus Sukuk is becoming less and less one which is guided by pricing.

In addition, it would seem that the expected liquidity shortfall faced by many oil-producing countries (typically the largest issuers of Sukuk) resulting from continued low oil prices finally paid dividends with respect to Sukuk issuance, as the volume of Sukuk issuance as at the third quarter this year has already surpassed the full year figures for 2016. That said, general market sentiment is that the liquidity gap has now been addressed and so this growth may be a short-term outcome, rather than the start of a new sharper upward trend.

Preview of 2018

The overall expectation for the Sukuk market in 2018 is continued sluggish growth. The performance of the Sukuk market is inextricably linked to sovereign issuances, which are determined in large part by the economic and geopolitical environment prevailing in the key Muslim-majority regions of the world, including some of the world's largest oil producers. Oil prices, while still low, have now largely stabilized. The initial funding response of governments facing oil-related liquidity squeezes was the issuance of large bonds to help alleviate immediate liquidity pressure. While we have seen the same governments subsequently turn to the Sukuk market in order to diversify their investor base and tap pockets of local and regional liquidity and GCC governments in particular still face significant financing needs (which some estimate to be around US$275 billion between 2017 and 2019), we anticipate that the conventional bond markets will still be the fundraising route of choice for sovereigns.

This continued reliance on conventional issuance over Sukuk is not the only trend which is limiting the pace of development of the Sukuk market in the near term; the following factors are also playing a role:

- Geopolitical risks: 2017 saw a group of countries place sanctions on a country in the GCC, potentially affecting cross-border trade and capital markets regionally. In addition, continued general unrest in the Middle East attributable to large ongoing conflicts in Syria, Iraq and Yemen has had a significant effect on non-regional investors going into the Middle Eastern Sukuk market. Finally, whereas 2017 saw significant economic growth for Iran, the recent change in administration and policy in the US toward Iran is adding uncertainty to that market which may reverse recent gains.
- Stabilization of oil prices: Whereas the last two to three years have seen a liquidity squeeze on oil-producing countries due to the sharp fall in historically high oil prices, this trend has now stabilized and liquidity is returning to oil-producing countries. While it is unlikely that we will see a return to the previously high oil prices of the first half of this decade, many of these oil-producing economies have now begun to adapt to the new reality. This likely means that the large sovereign Sukuk issuances seen in 2017 and late 2016 are unlikely to be repeated as the major liquidity gaps have been filled and governments have found other ways to reduce their funding gaps going forward.

Looking through 2018 and beyond, however, positive trends for long-term stable growth in the Sukuk market continue to develop and emerge, including:

- Less perceived 'difficulty' in executing Sukuk: While issuing Sukuk is still more time-consuming, complex and expensive than issuing bonds, efficiencies in terms of time and cost have increased in recent years due largely to the increased standardization and awareness/understanding of market participants of Islamic financing structures and documentation which have been driven by issuers, arranging banks, lawyers, standard-setting bodies (such as AAOIFI) and other stakeholders.
- Yield curves established in potentially large Sukuk markets: 2017 saw the issuance of Sukuk by several large sovereigns in markets where there has traditionally been little pricing guidance for the Sukuk market. It is expected that with the large issuances now completed, the established yield curves will lead to an increase in issuances by government-related entities and large corporates. These yield curves are also showing a continued price gap between Sukuk and their conventional counterparts.
- The opening of new markets: The market is also expecting increased sovereign issuances out of Africa from existing issuers (such as South Africa, Senegal, Nigeria, Cote d'Ivoire and Togo) and new issuers (such as Tunisia and Morocco), some potentially coming to market before the end of the year, looking to tap international liquidity to help meet their share of Africa's infrastructure deficit.

Conclusion

While continued slower growth seems to be the generally accepted prediction for the global Sukuk market, it may be that this is the cost of a healthier Sukuk market in the long term. With the increase of price parity between Sukuk and their conventional equivalents, the continued standardization of Sukuk documentation and accounting principles and the hope for an increase in the geopolitical stability in some key Sukuk origination markets, signs point to a stable future for Sukuk generally.

The Shariah governance system

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Shariah governance remains a critical component of the Islamic finance industry. A robust Shariah governance framework underpins an effective corporate process by Islamic financial institutions to achieve end-to-end Shariah compliance.

Nonetheless, as legal and regulatory frameworks are country-specific, Shariah governance frameworks differ markedly across jurisdictions. The prevailing legal and regulatory system of a country broadly determines the structure, type and implementation of the Shariah governance framework for the Islamic finance industry. This article captures a cursory view of the latest initiatives taken by regulators in Malaysia, Bahrain, Pakistan, Indonesia, Turkey and Nigeria in strengthening their Shariah governance frameworks.

Review of 2017

Malaysia, as one of the leading Islamic finance industry hubs, took a major step by enacting the Islamic Finance Services Act (IFSA) in 2013. The IFSA represents the culmination of efforts to provide a robust legal framework for Islamic financial institutions in Malaysia, in particular regarding the aspect of Shariah compliance. The IFSA emphasizes total Shariah compliance in the Islamic finance industry through Shariah governance and Shariah standards for each contract used in Islamic finance transactions.

This year, the Central Bank of Bahrain (CBB) announced its new Shariah governance regulations, which will be applicable to wholesale and retail Islamic banking in the country. This is indeed a positive move toward centralizing and developing both the banking and capital market sector in Bahrain. The CBB made it compulsory for Islamic banks to carry out an independent external Shariah audit.

The State Bank of Pakistan continues to support the country's rapidly growing Islamic banking sector and enhance the Shariah governance framework which was issued in 2014 and came into effect in 2015 to maintain a Shariah compliant environment for Islamic financial institutions. For 2017, Pakistan engaged with its market to find new ways to tighten its Shariah governance framework, especially in the area of Fatwa pronouncements.

In Indonesia, considerable progress has been made to strengthen Shariah governance under the oversight of a centralized Shariah board: the National Shariah Board of the Indonesian Ulama Council (DSN-MUI). DSN-MUI is an independent Fatwa-setting body that is also responsible for the appointment of Shariah committees of Islamic financial institutions. DSN-MUI and the Indonesian Financial Services Authority (OJK) signed an MoU to coordinate Fatwa issuance and the supervision of the Shariah committees of Islamic financial institutions.

In Turkey, all participation banks have Shariah advisors and boards, but their organizational setup is not standardized. Recently, Turkish authorities have been pushing to establish a nationwide advisory board for Islamic banking, set up a Shariah governance framework for those banks, increase instrument variety and improve education.

Regulatory and advisory entities will be established under government institutions such as the Banking Regulation and Supervision Agency and the Capital Markets Board. The Participation Banks Association of Turkey in Turkey has proposed the establishment of a centralized Shariah board to serve the banking industry.

Nigeria has issued a number of regulations and guidelines to operationalize the provisions of the legal frameworks for non-interest banking.

The Central Bank of Nigeria (CBN) also issued guidelines to provide minimum standards for the operation of non-interest banking, including licensing requirements, corporate models, financial instruments, corporate governance, Shariah councils, the conduct of business standards and profit-sharing investment accounts.

Preview of 2018

It is clear that each jurisdiction has a particular position on how to develop the Islamic finance industry and likewise how to develop a Shariah governance framework. The level of development of the Shariah governance framework varies across jurisdictions in accordance with the level of the Islamic finance industry development.

Some countries have very well-structured Shariah governance. However, in certain jurisdictions, the framework is not well structured, which creates some uneasiness among industry players and leaves Shariah advisors without clear guidelines to be followed.

With the latest Bank Negara Malaysia (BNM) exposure draft on Shariah governance, some changes are expected in the Islamic finance industry in Malaysia. These include: increasing the role and responsibilities of the board, and its need to ensure continuous development and strength in understanding Islamic finance and Shariah governance policies; the independence of the Shariah committee, while still allowing the board and senior members to provide useful insights to the committee; the encouragement of the board to appoint Shariah committee members as board members, etc.

The recent announcement of AAOIFI's issuance of Governance Standard No 8: Central Shariah Board and No 9: Shariah Compliance Function will further support and strengthen the development of Shariah governance in the Islamic finance industry.

Moving forward, it seems there is movement toward having a Higher Shariah Board Authority that could harmonize and direct the development of the Islamic finance industry. Therefore, Islamic finance industry players should push forward this agenda and request a Shariah governance framework to be established. This is because a proper Shariah governance framework would not only support the development of the industry but would make the industry more effective and efficient in ensuring strict Shariah compliance.

Conclusion

It is acknowledged and realized that there is no single 'one size fits all' for Shariah governance frameworks. ISRA Research Paper No 50 (2013) titled "A Comparative Analysis of Shariah Governance in Islamic Banking Institutions across Jurisdictions", however, finds that the centralized structure could provide more efficient Shariah governance. The centralized system provides standardization and harmonization of Islamic finance practices.

For the further development of the industry, it is recommended that a comprehensive Shariah governance framework and detailed provisions on Shariah governance should be in place so that we can ensure a totally Shariah compliant industry.

Shariah standards: A continuous effort to strengthen compliance culture

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Islamic financial transactions are structured based on particular Shariah contract(s). The basis and requirements of the Shariah contract make reference to jurists' opinions based on their understandings (Fiqh) from the main sources; the Holy Quran, traditions (Sunnah) of the Prophet Muhammad (peace be upon him) and the major schools of jurisprudence. Interestingly, there are differences of opinion in certain rulings of Shariah contracts due to different interpretations of the Islamic sources by the Islamic scholars. These are later translated to diversity and flexibility in the offering of Islamic financial services and products.

While the flexibility in Shariah opinion has been contributing to global growth in Islamic finance, one may think that it is better to have a set of basic standards that are agreed upon to become the reference for the main structure of Islamic products. Although the standards outlined similar dominant opinions for the main principles of the Shariah contract, different Shariah opinions for certain Shariah issues may be cross-referred to give way to innovation in the fast-changing industry. These standards also encouraged fruitful discussions among industry experts to comprehend certain critical issues in Islamic finance.

"Although the standards outlined similar dominant opinions for the main principles of the Shariah contract, different Shariah opinions for certain Shariah issues may be cross-referred to give way to innovation in the fast-changing industry"

Among the most prominent international standard issuers are AAOIFI, the IFSB and the International Islamic Financial Market (IIFM). AAOIFI covers large segments including banking, insurance, investment banking and capital markets among others, while the IFSB focuses on producing global standards and principles in relation to systems and procedures. On the other hand, the IIFM specializes in standardization relating to capital and money markets, corporate finance and trade finance. On the domestic front, we can see that Bank Negara Malaysia (BNM) has been actively rolling out various Shariah standards and guidelines to govern the operation of Islamic financial institutions in Malaysia.

The preparation of Shariah standards is not the sole effort of the standard-setting bodies. In general, they shall engage with industry practitioners to prepare the draft which will thereafter be circulated and discussed extensively to generate feedback and further recommendations or justifications. Only after the feedback had been thoroughly addressed can the draft be published as a Shariah standard.

An important highlight is that all those standards are always subject to revision in order to keep up with changes and innovation in the Islamic finance industry. Unlike BNM policy documents which are binding on the local Islamic financial institutions in Malaysia, it is optional for any Islamic financial institution in the world whether to adopt the international standards and guidelines on a mandatory or optional basis.

Review of 2017

The effort of rolling out Shariah standards and guidelines has always been a continuous one to ensure the reliability of these standards to meet the requirements of the industry. In April 2017, the IFSB issued the Guiding Principles on Disclosure Requirements for Islamic Capital Market Products (Sukuk and Islamic Collective Investment Schemes). This standard intends to provide a basis for regulatory and supervisory authorities to set rules and guidelines on disclosure requirements for Islamic capital market products.

AAOIFI also rolled out its 58th Shariah standard on repurchase during its 47^{th} meeting held from the 9^{th}-12^{th} March 2017. The new standard aims to prescribe Shariah rulings on repurchase and its application by Islamic financial institutions. The IIFM started the year with the publication of the Islamic Credit Support Deed for Cash Collateral (Variation Margin). On the local front, BNM is finalizing drafts for Bai Al Sarf and Rahn. Since beginning to produce standards covering main Shariah contracts in 2013, BNM has rolled out 13 standards (known as policy documents) on the following: Hibah, Ijarah, investment accounts, Istisnah, Kafalah, Mudarabah, Murabahah, Musharakah, Qard, Wakalah, Tawarruq, Wadiah and Waad as of 2017.

Preview of 2018

AAOIFI has been developing a new landmark initiative, namely the Waqf Standards Packet which shall comprise three detailed standards: Shariah standards, accounting standards and governance standards. These three categories of standards shall cover all aspects from Shariah rulings regarding the Waqf concept, to the recommended regulations, governance and accounting templates for Waqf. This mega initiative of Waqf standards is estimated to be completed by the end of 2018.

On the other hand, the IIFM has commenced a three-year strategic plan to expand its standardization initiatives and other services to new segments and areas including the standardization of new products and agreements. The IIFM is also working on the Islamic Risk Participation Agreements standard related to the trade finance business and shall also initiate the development of standard Sukuk documentation and market guidelines.

Conclusion

The task of preparing Shariah standards would not have been achieved without the collaboration and tremendous efforts of all parties. Their efforts can be regarded as highly successful since these standards now provide ease of reference for the Islamic financial industry and indirectly boost the efficiency of the industry itself.

It is hoped that the issuance of Shariah standards will strengthen the Shariah compliance culture among Islamic financial institutions in their products and services.

Islamic structured finance – from a notable year to slower progress

Stuart Jarvis *is the investment director at Amiri Capital. He can be contacted at stuart.jarvis@amiricapital.com.*

For the Islamic finance industry, asset-backed securitization in the form of Sukuk dominates and can be mistakenly taken as a synonym for the industry as a whole. Nonetheless, the size, as well as the vibrancy, of the Sukuk market is seen by most as an important bellwether for the Shariah compliant investment market.

Many of the structured financings that sit within a Sukuk facility allow countries and corporates to leverage on their assets, which can be as much a product of fiscal necessity as prudent financial planning. While the burgeoning size of the Sukuk market may grab positive headlines, it also represents a growing debt burden.

“As praise is heaped on larger Sukuk volumes in 2017, it should not be forgotten that these are largely leverage products. For growing economies, a concomitant rise in leverage is of less concern”

Review of 2017

2017 has been notable for the sovereign Sukuk issued and none more so than the maiden US$9 billion issuance by the Kingdom of Saudi Arabia.

The fact that Saudi Arabia entered the debt markets at all is a stark reminder of the budget deficit facing the country. Along with the fall in oil prices, the country's population grows apace, with 45% of the population under 24 years of age.

The Saudi Sukuk adopted a structure wherein 51% of the proceeds was used in a Mudarabah investment agreement. The balance was used in a Murabahah facility. The five-year maturity notes pay 2.89% per annum, with the 10-year paper paying 3.63% per annum. The issuance was reportedly three times oversubscribed.

Less feted by commentators than Saudi Arabia's maiden Sukuk, but no less eye-catching, was Nigeria's US$278 million debut. The seven-year Ijarah-based facility pays a vertiginous 16.47% per annum and was fully subscribed. The proceeds will “be used solely for the construction and rehabilitation of key roads across six geopolitical zones across the country”, according to the offer for subscription document.

A review of the 2017 structured finance market cannot ignore the ongoing dispute between Sukukholders and the issuer, Dana Gas. The US$700 million Sukuk facility issued in 2013 is said by its issuer to be invalid, given the changes in Islamic finance practices since the issuance date. With dual legal cases being heard in Sharjah and English courts, at the time of writing, the dispute is ongoing. The fall-out from

the case should not be underestimated, as it plays to the concerns of potential Sukuk investors who fear that their investment is less safe in a Shariah compliant instrument than in a conventional version of the same.

Preview of 2018

As 2017 draws to a close and the new year is ushered in, it is hard to foresee 2018 being such a plentiful year for Sukuk issuances. The US$9 billion Saudi issuance clearly had a huge impact on 2017 volumes, with no sovereigns or corporates tempting the market with signs that they will offer a similar size in 2018.

Of the new entrants, Algeria is planning a modest debut sovereign Sukuk in 2018 and is in the process of setting the required legal framework to do so. Shariah compliant financing structures had not been traditionally popular with the Algerian government. With the passing of time, and an income gap caused by the fall in energy prices, the government is expediting the path toward an issuance in 2018. Thereafter, it is expected that further Sukuk of smaller sizes will be issued until 2022.

The Dubai government-controlled Dubai Aerospace Enterprise (DAE), now one of the world's largest aircraft lessors, also signaled a move to issue its first Sukuk in 2018. Given the desire of DAE to change its capital structure toward a higher percentage of unsecured debt, it will be interesting to see what Sukuk structure is adopted and where it will be priced to attract investors.

At a macro level, a key driver further slowing Sukuk issuances into 2018 is currency depreciation among some of the traditional participants in the Islamic finance industry. As the US dollar starts to appreciate, those GCC currencies pegged to it are protected. In those countries in the wider Islamic world whose currencies are not pegged to the US dollar and have seen a deterioration in their currencies, there has been a resultant reduction in Sukuk issuances.

Much has been written and spoken about the standardization of documentation within the Sukuk market. This would provide for a more efficient market and encourage wider investor participation in the market. However, there are no portents to suggest that anything will change in this regard in 2018.

Conclusion

The Sukuk market continues to be viewed as synonymous with the Islamic finance industry as a whole. As praise is heaped on larger Sukuk volumes in 2017, it should not be forgotten that these are largely leverage products. For growing economies, a concomitant rise in leverage is of less concern. Where budget deficits have forced sovereigns and corporates to issue Sukuk, a slower 2018 might not be such an unwelcome forecast.

After a challenging 2017, will re-Takaful rise to the next level?

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Even though Takaful has continued to grow in Asia, there is a common understanding that Takaful is becoming stagnant in the region, especially in the key markets of Malaysia and Indonesia.

Review of 2017

The contribution figures of the two biggest markets in Asia for the first half of 2017 suggest that the Takaful industry has done well so far. In Malaysia, General Takaful grew by almost 6% to RM1.3 billion (US$312.3 million) compared with a year ago. Similarly in Indonesia, overall Takaful contributions increased by 3.5% to IDR6.16 trillion (US$455.35 million).

"By continuously embracing new technologies and focusing more on consumer needs, Takaful in Asia can be brought to the next level and emerge as a true solution for customers"

However, this may simply be a reflection of growth in the entire insurance industry as conventional insurance grew by a similar percentage, or even more in Indonesia where conventional insurance grew by almost 20%.

In the midst of challenges, the Takaful industry in Malaysia is also currently focusing on multiple regulatory changes, such as the splitting of the composite license by mid-2018, the introduction of the new Family Takaful framework and the abolishment of the motor and fire tariff.

Bank Negara Malaysia (BNM) had also voiced expectations at the beginning of the year for the industry to step up on the innovation of product offerings and delivery channels. It wanted more affordable protection products developed for the underserved segment, and for the industry to embrace new technologies such as blockchain to accelerate risk-sharing transactions and provide trade credit protection for SMEs. Finally, the industry should apply the various Shariah contracts more dynamically to diversify their product offerings. While the industry has come up with several initiatives to fulfill these expectations such as a starter kit for new customers, a lot more still needs to be done.

In Indonesia, most Takaful companies are window operations and this is detrimental to the growth of the industry given the fact that they cannot put in the required resources to develop their Takaful business. Therefore, it is good to see that some insurers are considering spinning off their Takaful window operations in the near future.

It is too early to say if the Islamic Finance Roadmap for 2017-19, which was launched by the Indonesian regulator, Otoritas Jasa Keuangan, in June will give a boost to the Takaful industry in the country.

In other parts of Asia, Takaful operators are small and it is unlikely that any of the other markets will grow to a size comparable to Indonesia or Malaysia in the near future. Looking finally at re-Takaful, operators face the same challenges as conventional reinsurers, namely a very soft market caused by overcapacity. In addition, a lot of re-Takaful operators still struggle to reach the necessary scale to make their operations viable.

Preview of 2018

Looking ahead to 2018, the challenges for the Takaful industry will remain similar to 2017.

In Malaysia, one key question will be the effects of the splitting of the composite license. It is expected that some composite companies may not continue writing General Takaful; their portfolios may be taken by other Takaful operators or new players entering the market.

While 2017 has not been successful with regards to mergers and acquisitions, with at least two planned acquisitions of Takaful operators not happening due to price disagreements, it can be expected that some of them will materialize in the coming months.

Also, the new Family Takaful framework is expected to lead to an increased focus on the development of protection products and the increased usage of new distribution channels such as the internet and Islamic banks. In this respect, it is interesting to note that one of the bigger Takaful operators in Malaysia has recently sold its entire agency force and is now focusing on direct distribution.

On the General Takaful side, companies will need to reduce their dependence on personal lines, especially fire and motor, as it is expected that the ongoing de-tariffication will lead to rate pressure and lower profits. One area where Takaful operators are expected to do more is with regards to the writing of large risks. There is an initiative by the Malaysian Takaful Association with the support of BNM to create a market pool for such risks which should become effective in 2018.

Another potential growth area is microTakaful, especially in Indonesia where a large proportion of the population has no insurance cover and Takaful could play a more significant role in reducing the protection gap.

Conclusion

In order for Takaful in Asia to grow again at a speed as it has in the past, it will not only have to successfully address the challenges outlined in this report, but also reconsider its unique value proposition and to present itself as a truly viable alternative to conventional insurance rather than competing head-on with it. Thereby, it can learn from other successful forms of insurance (eg peer-to-peer insurance; discretionary mutual insurance) which have recently emerged and are similar to Takaful.

By continuously embracing new technologies and focusing more on consumer needs, Takaful in Asia can be brought to the next level and emerge as a true solution for customers.

European Takaful emergence

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Muslims now number 16 million in the EU, with one of the highest rates of banking and insurance penetration in the world. Muslims in Europe are among those with the most bank accounts and insurance coverage. This high penetration rate can benefit the Takaful boom in this zone. In addition, there are many forms of insurance companies provided by European jurisdictions to practice both General and Family Takaful while remaining faithful to the principles of mutualism and philanthropy.

The official Brexit negotiations between London and the EU started on the 19th June 2017 in Brussels. The negotiations should be completed in two years, on the 29th March 2019, as provided by the treaties. The political consequences of Brexit for the EU are difficult to predict and the economic consequences for the UK are also unpredictable as the experts are unable to speak with one voice. The exit of the EU has not taken place yet and the UK economy has not suffered damage despite the fall of the pound sterling in the months following the referendum in June 2016.

Nonetheless, the London market of Islamic Takaful insurance has not been left out and in Europe, countries like Germany, Spain and France are beginning to structure their offers in order to meet the demand of their Muslim populations.

Review of 2017

Recently, US insurer AIG, in collaboration with London broker Cobalt Underwriting, presented the first Takaful insurance policy for the MENA zone. This policy protects investors making mergers and acquisitions in this area from any risk of asset depreciation related to mispricing.

The London office also has a lobbying institution: the Islamic Insurance Association of London (IIAL) whose main objective is to promote the London Takaful insurance market. The IIAL has been formed to create a truly representative body to support the work of those in the UK reinsurance markets who are transacting Islamic finance.

Development must continue with a new re-Takaful capacity offered by Lloyd's Dubai. The creation of this platform potentially offers a re-Takaful capacity for business risks and allows London to increase its footprint in the Middle East and Southeast Asia.

Germany was the first western country to tap the Islamic capital markets in 2004. With the largest economy in Europe and a large Muslim population, Germany has everything to see its Islamic financial sector grow. In 2017, the first Islamic bank in continental Europe, KT Bank, opened a new branch in Cologne and INAIA Finance launched a new Family Takaful product brought by FWU.

In Spain, Mussap signed an agreement with CoopHalal, Spain's leading Islamic financial services cooperative. Through this agreement, the entity will offer different Takaful products from Mussap and Previsora.

In Europe, the market for Islamic finance and insurance remains a niche: conventional operators fear a risk for their image. In France, this is the main reason why the Takaful distribution model is based on brokers' networks allowing the transfer of reputational risk from risk-bearers to distributors. In 2017, brokers' networks continued to grow with the opening of new branches for Noorassur and the emergence of new brokers such as Coveris Assurance, Dine Assur, Ethical Capital, MKSS, NCC, Courtifi and Keen Finance.

Preview of 2018

With strong domestic demand, substantial purchasing power and a high penetration rate, the European Takaful market will continue to consolidate and London has a considerable lead over other European financial places which have remained at a standstill in this area.

The key elements that can allow the development of a strong Takaful market in Europe are multiple. First, it is important to demystify in order to convince institutional operators of the considerable growth reserves offered by this segment. Secondly, it is necessary to carry out promotional and information campaigns in the media to stimulate demand.

Finally, supply must help create the market. To achieve this objective, human, financial and information technology resources must be invested in the design and management of new products adapted to the needs of compulsory insurance, and must be able to cope with rapid growth.

Takaful insurance players must improve innovation and broaden the scope of the offers through multidistribution while offering high-quality service. This is why European players in 2018 will continue to design and offer new solutions.

In France, SAAFI as a wholesale broker should deliver to the market new Takaful offerings including funeral and credit insurance. According to Les Echos Etudes, the potential turnover of Takaful in France is estimated at EUR3.5 billion (US$4.13 billion) or 1.7% of the market.

Conclusion

The Takaful industry should not have too much difficulty in developing itself in Europe, because the European market is more welcoming in terms of the adoption of tax instructions and the development of the Halal market, and also has high-level expertise with advanced skills and many small and medium players despite a lack of investment and communication.

The adoption of digitalization is a factor that should allow Takaful to realize its full potential in Europe. Digitalization has the ability to disrupt existing business models, because of its ability to transform and reinforce product innovation, transparency, services, cross-selling, engagement and customer experience.

A strategy to meet the needs requires adapting to the needs and evolution of the expectations of customers. A defensive strategy would be to copy the products of other conventional players in the market.

Strategically, it is mandatory to use an approach that adapts, improves and creates new products that meet the needs and sociocultural values of individuals. It is therefore necessary to establish a differentiation strategy based on compliance and on the embodiment of the alternative values offered.

Takaful must also be available to non-Muslims. There are more non-Muslims than Muslims in Europe and many of them would appreciate the ethical, transparent and equitable nature of Takaful.

Takaful in the Middle East: Opportunities and challenges

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Like other segments of Islamic finance, Takaful is also a part of the global financial system and thus the global economy. In other words, the global economic condition can have an impact on Takaful operators around the world, including operators in the Middle East. This is because the integration and interconnectivity of financial markets all over the world means movements in a market will have direct or indirect impacts on other markets.

Review of 2017

The current economic condition is actually pretty favorable for the insurance industry in general, including the Takaful segment. With developed economies like the eurozone expected to grow by 2.1% this year and the real GDP of the US increasing to an annual rate of 3.1% in the second quarter of 2017, the prospects for the Takaful segment are promising.

The aforementioned positive economic growth has boosted the insurance premiums volume globally both in life and general insurance businesses. In 2017, the non-life insurance business has been growing at the rate of 2.2% while the life insurance business has been growing at the rate of 4.8%. The insurance industry's growth is primarily driven by the growth of the businesses in emerging markets like the Middle East.

For example, the compound annual growth rate (CAGR) of the total gross premiums in the MENA region during 2006-15 stood at 11%, which is remarkable. The same also applies in the Takaful segment. For example, during 2012-15, the CAGR of gross contributions written in the GCC stood at 18% which was spurred by the governments' policies on mandatory insurance and improvement in the public awareness level.

Despite the good developments within the insurance industry and the Takaful segment, the potential of Takaful businesses in the region is still far away from its optimum level. For example, the insurance penetration rate is still relatively low in the Middle East, at below 2% which is much lower than the global average. Actually, this should be seen as an opportunity that must be explored by Takaful operators in the region in 2018 and years to come.

Preview of 2018

The year of 2018 is expected to offer a lot of opportunities for Takaful operators in the Middle East. For example, high investment in infrastructure by governments in the Middle East in recent decades aimed at spurring their countries' economic growth offers an opportunity for Takaful operators to write more underwriting incomes. Moreover, the Family Takaful business is still relatively untapped in previous years.

Currently, the Family Takaful business only represents about 15% of total contributions of Takaful in the MENA region, meaning that this business offers a lot of opportunities. With the improvement in public awareness and a better economic condition in most of the countries in the region, the business is expected to grow significantly in the years to come. In addition, the cutting of subsidies in most GCC countries means less benefits provided by the governments, indicating potential businesses for private pension and annuity plans for insurance and Takaful companies in the region.

Another important point to highlight is that the agency distribution channel for Family Takaful has still not yet been well implemented in the Middle East, thus, offering opportunities for the locals to participate in the agency scheme. All Takaful stakeholders in the region should work together in order to grasp those opportunities in 2018 and beyond. For example, regulators in the region should continuously improve the regulations for the Takaful segment especially in the areas of corporate governance and technical underwriting. The new regulations are expected to make Takaful operators more efficient to help the Takaful segment to expand.

In addition, consolidation among Takaful operators is encouraged since there are too many players in the overcrowded market especially in the UAE where the number of Takaful operators is already overwhelming.

Although in general there are plenty of opportunities for Takaful operators in the Middle East, in order to sustain the development of the Takaful segment and move forward, there are several challenges that need to be overcome by operators. Firstly, in many countries in the Middle East especially GCC countries, the majority of the population are expatriates who prefer short-term investment products than long-term Family Takaful products. This has become one of the challenges standing in the way of Family Takaful operators expanding their businesses. Therefore, innovative product development to suit potential customers' needs must be conducted.

Secondly, there is the lack of a comprehensive and robust regulatory framework with the exception of countries like Bahrain and the UAE. As a result, policyholders' interest is put after shareholders' interest. Therefore, enhancement in the regulations must be conducted. Introducing specific laws for Takaful in Middle Eastern countries that still do not have the laws is of utmost importance and need to be speeded up.

Thirdly, there is a lack of available human resources. Collaboration with academic institutions, especially higher learning institutions, is highly recommended to tackle this issue. Producing more qualified graduates is greatly needed to boost the development of Takaful in the region. Lastly, there is a lack of innovative products. Most Takaful products offered by operators in the region are still mimicking conventional insurance products, thus making it difficult for the public to differentiate. Therefore, product development based on Maqasid Shariah should be applied to tackle this issue.

Conclusion

The development of Takaful businesses in the Middle East until 2017 has been remarkable and their prospects in 2018 are encouraging. There are still ample opportunities that have not been explored by Takaful operators in the region. However, Takaful stakeholders in the region must overcome the current challenges that the operators are facing so that a brighter future for the segment can be realized.

Islamic finance competing with one hand tied behind its back without level-playing field

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The GCC constitutes a region the fortunes of which have been driven and dominated by the price of crude oil over most of the past 60 years. While the six member states of the GCC all struck oil at different times over the past 60 years and flourished accordingly, they did share one area in common which was the absence of a direct tax on consumption whether in the form of income tax or value-added-tax (VAT). As such, the GCC has been the marvel of the global expat community and many expat families can proudly claim to have had up to three generations of their family living and/or raised in the GCC.

There has been talk of the introduction of a VAT into the economies of the member states of the GCC since at least 2007. At the time, those discussions were swiftly swept away by the tsunami of the global credit crisis. Ten years on though and VAT is very much back on the agenda in the GCC. At the same time, uncertainty remains as to the exact treatment of certain goods and supplies under the new VAT regime and while the relevant authorities have released some guidance, remarkably little has been said in the public domain to date with respect to the application of VAT to Islamic financial services.

> “It is critical that all tax authorities make a clear statement regarding the treatment of Islamic finance such as that VAT is to be applied in a manner consistent with its closest conventional counterpart”

Review of 2017

The GCC economies, like all economies, must diversify their economies away from a dependence on oil while the fallout from the global credit crisis and subsequent individual financial institution crises has led some outsiders to suggest that they are bordering on tax havens. Whatever may be the truth of the matter, things have been put into perspective during 2016 and 2017 as global crude oil prices seemed to collapse all over the world. The governments in the GCC were facing a significant shortfall in revenue against budgeted expenditure and this had to be compensated for.

Thus, 10 years on, VAT is back on the agenda in the GCC with all six member states signing up to a joint framework setting out their intention to introduce VAT into the region at a uniform rate of 5% with an effective date of the 1st January 2018. Or so it would seem. 2017 was a challenging year for everyone, both economically as well as politically and it took its toll. The majority of 2017 was spent waiting for the national VAT laws to be released in each of the GCC member states followed by detailed executive regulations and legislation providing further clarity as to how to treat some of ‘the devil in the detail’. The wait was agonizing for many and some chose the ostrich approach of sticking their heads in the sand and insisting that VAT would be delayed if not canceled outright. How close they were: as of today, while national VAT laws have been released, we can only be certain that, with effect from the 1st January 2018, only the UAE and Saudi Arabia have confirmed definitive plans to introduce VAT at a rate of 5%.

However, as we approach the end of 2017, the exact treatment of Islamic financial products under these VAT laws remains to be seen in practice. Some appear to have taken the view that VAT will be applied in a uniform manner across both conventional and Islamic financial services. Others are less sure and point to the fact that other economies with significant levels of Islamic financial services have needed to introduce reams of additional VAT guidance and legislation to address some of the nuances in the transaction flows of Islamic products.

Preview of 2018

So what will 2018 have in store for us? With respect to the GCC member states other than the UAE and Saudi Arabia, it is likely to be more of 2017 such as continued speculation and second-guessing as to whether VAT will ever actually be introduced. The speculators and second-guessers will pay close attention to any perceived successes and failures of the UAE and Saudi Arabia as they move to implement VAT for the first time.

As for the UAE and Saudi Arabia themselves, the momentum is gathering pace rapidly. The UAE has established a new Federal Tax Authority responsible for implementing all VAT related laws and legislation while the pre-existing Saudi General Authority of Zakat and Tax has assumed responsibility for this. While there has been some very brief discussion of how VAT will be applied to Islamic financial products in the GCC, in practice, nothing will be certain until the relevant authorities have reviewed the VAT treatment of these products in detail and compared the treatment both within the same industry as well as to how VAT is applied to these products in different jurisdictions.

This is where the challenge lies, for VAT is, in principle, a type of general consumption tax that is collected incrementally, based on the surplus value, added to the price on the work at each stage of production. As such, the concept of VAT lends itself naturally to agricultural and manufacturing enterprises but arguably less so to financing. Indeed, tax authorities have historically struggled to apply VAT to modern financial services with the result that many financial services products are exempt from VAT.

So where does this leave Islamic finance when many of its products are actually designed to add value to the underlying tangible asset being traded? Should the VAT treatment of Islamic financial products follow their form or substance? If one looks to other jurisdictions which offer Islamic as well as conventional financial products such as the UK and Malaysia, we can see that typically, the ultimate objective of the local tax authorities is to achieve a level-playing field between both sets of products for all consumers to choose from.

Conclusion

2018 is shaping up to be quite an interesting year. A number of matters, quite apart from VAT issues, will make themselves clear as we enter the new year. However, with respect to the VAT treatment of Islamic finance going forward, we believe it is critical that all tax authorities make a clear statement regarding the treatment of Islamic finance such as that VAT is to be applied in a manner consistent with its closest conventional counterpart. Without this, and in a world dominated by conventional financial institutions, Islamic finance will only be trying to compete with one hand tied behind its back.

Moribund to energized: The effect of fintech on innovation in Islamic finance

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Even the biggest proponents of Islamic finance would accept that, to a large extent, its achievements are limited to providing Shariah compliant solutions by mirroring the economics of conventional finance. Although in its infancy, Islamic fintech provides a genuine opportunity of moving away from this straightjacket.

Although the application of technology within the Islamic finance industry covers the main areas such as financing and payments, infrastructure, operation, risk management, data security and customer interface, the other areas that fintech covers show how fintech can energize and create genuine innovation in Islamic finance. These include crowdfunding, peer-to-peer (P2P) lending, money transfer and mobile payments, wealth management and insurance. Fintech innovation in these areas can provide Islamic finance solutions in a manner that were previously not available.

“Fintech has brought energy and verve back to Islamic finance and combined with AAOIFI's November 2016 ruling on gold, we could be at the dawn of a new era”

Review of 2017

2017 has largely been a catch-up period for Islamic institutions looking to match the innovation of their conventional counterparts. To put this into context, Accenture has calculated that only 1% of the GBP50 billion (US$65.85 billion) invested in fintech across the globe has gone to the MENA region. So why has Islamic finance been so slow to adopt fintech? Especially with Dubai positioning itself as an Islamic finance hub and stating that the digital Islamic economy is one of the key pillars to achieve its strategy. There is no clear answer, especially as there is access to mobile technology and fintech provides payment services for two billion of the world's population whot are unbanked, many of whom are Muslims.

Highlights of 2017 have included the setting-up of Human Crescent, a crowdfunding program to re-orient Zakat for contemporary needs. Another crowdfunding program, Muslim Women Tech, has been established to offer new products for funding every quarter. Yielders, a London-based financial technology company, has become the first Islamic fintech company to be given regulatory approval in the UK by the Financial Conduct Authority, in a move which emphasizes the UK's desire to be a hub for Islamic finance and fintech.

Preview of 2018

2018 should see a dramatic growth in Islamic fintech. Crowdfunding and P2P lending provide genuine solutions to allow Shariah compliant investments. The Islamic economic paradigm is asset-

backed and based in the real economy. To date, Islamic finance has been hijacked by conventional bankers who have reverse-engineered conventional debt products. However, Islamic fintech is supported by professionals from a diverse background with a different set of objectives not based around conventional financing models. Crowdfunding and P2P provide genuine Shariah compliant investment platforms.

Using artificial intelligence to screen Shariah compliant equities should promote investment in Shariah compliant companies and may promote a more ethical approach to business.

In November 2016, AAOIFI made a ruling that gold was a Shariah compliant product, which resulted in the setting-up of Goldmoney, which provides financial products fully-backed by gold. This ruling is arguably responsible for the most exciting development in Islamic fintech: Islamic cryptocurrency.

OneGram is a Dubai based technology company behind the world's first digital currency, fully back by gold. It is similar to bitcoin, in that it is a digital currency, but different in that if bitcoin were to crash, its value could go to zero. With OneGram, the value of the currency is backed by gold so it cannot crash to below the value of gold that the currency represents. This will make it an attractive safe investment for certain types of investors, particularly in Islamic and third-world and developing countries.

There are others interested in entering into the Islamic cryptocurrency space, and aim to make returns through maintaining blockchain and security, enabling the coins to trade and receiving a payment for every trade. Key to facilitating the development of gold-based cryptocurrencies will be vaults where such gold is housed as well as the jurisdiction, security over such gold, auditing procedures and the blockchain technology.

Conclusion

Muslims account for more than one-fifth of the world's population but only 3% of the world's financial products are structured on a Shariah compliant basis. Innovation has been drained out of the industry in favor of tried and tested products. Fintech has brought energy and verve back to Islamic finance and combined with AAOIFI's November 2016 ruling on gold, we could be at the dawn of a new era.

Islamic finance here to stay in Afghanistan

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People in Afghanistan have moved to Islamic finance and rejected interest-based loans despite a lack of laws and regulations, lack of human aptitude, lack of public responsiveness, lack of investment and the current political and unstable situation in the country.

The current observations show that Islamic finance is here to stay and will move to a more favorable level as long as the need for it is increasing with each passing day.

Review of 2017

The stability of Islamic finance in 2017 in Afghanistan was almost jeopardized due to security concerns as Islamic finance institutions were experiencing a great decline in the Islamic market, yet somehow Islamic finance in Afghanistan managed to make some progress. Despite all the challenges that Islamic finance institutions encountered, they played a significant role toward contributing to the growth of Shariah compliant financings.

Da Afghanistan Bank recently introduced a public credit registry which will make it easier to track the records of all borrowers. General awareness campaigns were conducted to inform the public about what Islamic finance really is.

More investors were encouraged to come forward and invest in Afghanistan to boost Islamic finance in the country. According to a report, most of the locals would not consider doing banking due to interest and are heading toward Islamic finance.

More banks are in the process of converting into an Islamic bank. In the past, general awareness of Islamic finance among the people had always been low, but conducting awareness campaigns has helped to contribute to the growth of Islamic finance.

Preview of 2018

Islamic finance in Afghanistan will benefit the most in the event the government of Afghanistan announces more Islamic finance-friendly laws and regulations that will attract more investors to come forward and participate in Islamic finance. If the government fails to attract more investors to invest in Afghanistan, Islamic finance will be expected to decline as well.

In addition, having more business opportunities also plays an important role in enlarging the Islamic finance industry. The presence of international donors is another factor which would play an important role that would contribute to the development of Islamic finance in Afghanistan.

Recently, the founder of Karwan University bought the Afghanistan Commercial Bank and applied for a license for Islamic banking. Islamic finance can be expected to be far comfortable when more workshops are conducted to increase awareness among the people. Diploma courses can help to train people in Islamic finance and universities can also play their role in establishing a course in Islamic finance/banking in Afghanistan.

Conclusion

It is clear that Islamic finance is not just a short-term phenomenon in Afghanistan; it is here to stay and there are sign that it will continue to grow as more people are attracted to it instead of conventional loans. One of the most significant factors that will help Islamic finance grow is the support that it should receive from the government. Moreover, it is also true that Islamic finance is easier, less risky and for sure the returns are quicker.

Australian Islamic finance growing steadily

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Australia's financial sector is well-developed, highly regulated and stable. The banking sector is dominated by the 'Big 4' banks – National Australia Bank, Westpac, Commonwealth Bank and ANZ. Many international banks have a presence in Australia but, to date, no Islamic banks. Australia is a proudly multicultural society and approximately 4% of the population identify as Muslims. While there are a small number of 'homegrown' Islamic financial institutions offering various financial services, the sector is underserviced in a number of key areas. The growth of Islamic finance in Australia is being driven by customer demand rather than regulatory or institutional dictate. This was the story of 2017 and is likely to be the case for the near future.

Review of 2017

The regulatory environment
There has been no real change in the regulatory environment during 2017.

The May 2016 federal budget (which set out the government spending priorities and programs for the coming year) made mention of recommendations to equalize tax treatment to facilitate asset-backed financing. But nothing happened. The May 2017 budget made no mention of finance and on the basis of a catch-all provision to cut any program which had not been introduced (the 'Zombie savings'), it seems apparent that there will be no changes to taxation laws.

The banking regulator, the Australian Prudential Regulatory Authority (APRA) issued a discussion paper in August 2017 on the introduction of restricted licences for authorized deposit-taking institutions. This is aimed at reducing the regulatory burden on new license applicants and reducing the capital requirement from AU\$50 million (US\$39.17 million) to AU\$3 million (US\$2.35 million). This could assist the launch of an Islamic bank.

Islamic financial services and investments
There has been moderate growth in the Islamic financial services sector.

In late 2016, Crescent Wealth partnered with KAF Investment Funds of Malaysia to launch the KAF Australia Islamic Property Fund. The fund gives non-institutional investors access to the Australian commercial property market by feeding into the Crescent Wealth Diversified Property Fund.

In mid-2017, Hejaz Financial Services launched the Global Ethical Fund which follows an 'ultra-ethical code of governance' for the purposes of selecting, retaining or realizing investments.

Property and construction finance
We saw significant financing activity over the past 12 months involving both domestic and international lenders.

National Australia Bank continues to lead the 'Big 4' in attracting Islamic borrowers with their Wakalah-based Shariah compliant financing facility. During 2017, the facility was utilized in the construction of an aged care facility, in the corporate and construction financing of pharmacy businesses and in commercial property acquisition.

It is understood that at least one other 'Big 4' bank dipped its toe into the Shariah compliant financing space in the past year. Other domestic lenders are looking at the sector with interest.

The year saw a contraction in bank participation in residential real estate development financing in Australia as a result of regulatory pressure from the APRA. This has led to an increase in the participation of second-tier lenders, mezzanine financiers and non-traditional lenders in this space. It also provides an opportunity for international Islamic banks to take a greater role.

This year saw the closing of the Wentworth Point residential development construction financing led by Maybank in Malaysia and utilizing a commodity Murabahah structure. The transaction involved the property arm of Malaysia's Lembaga Tabung Haji, TH Properties, through its relationship with Piety Capital.

Islamic real estate investment
Indicative of greater Islamic investment interest in the Australian property market, the year saw the arrival of leading ethical real estate advisors 90 North Group.

> The pullback by the leading lenders in property development and construction financing will offer further opportunities for offshore Islamic lenders and Shariah compliant products

"In the last six months, we've seen significant interest from the Middle East – Saudi Arabia and Dubai in particular – [in] considering capital on a Shariah basis. We are very hopeful of the Middle East market and we think the market will continue to grow dramatically in terms of providing Shariah capital to Australia," commented Michael Dowling, a partner and the head of Australia for 90 North Group.

We are also aware of broader interest in the Australian real estate market from a number of other Middle East and Southeast Asian investors, and further Shariah compliant property transactions, particularly in the commercial property space, are expected.

Preview of 2018

We expect the year ahead to offer more of the same.

Given the current dynamics of the federal parliament, it is safe to assume that Islamic finance and the necessary legislative amendments to the taxation regime at both the state and federal levels will not be a priority.

Further growth in Shariah compliant investment funds and superannuation is also likely; these are traditionally areas where Australian investors are heavily focused.

The pullback by the leading lenders in property development and construction financing will offer further opportunities for offshore Islamic lenders and Shariah compliant products.

Conclusion

Australia remains a jurisdiction with potential for growth in Islamic finance. Without regulatory or government assistance, this growth will continue to come from customer demand.

Embracing innovative strategy approaches in financial services

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Resilience in business in Bahrain is a differentiator, where the Kingdom has continued to show signs of reasonable economic growth at 2.9% in the first quarter of 2017. The banking sector, which represents an important share of the GDP, also showed increased levels of profitability and performance.

> The strategy of embracing innovative technology in relation to the fintech landscape will hopefully help the Kingdom to secure a leading edge in inward investment

However, the impact of low oil prices and stressed governments' budgets in the GCC is also felt noticeably in the Kingdom and policymakers and regulators are making the necessary changes to adapt to the new reality and prioritize strategies which will empower the private sectors to lead economic growth and prosperity. The government has also introduced generous social support and reasonable taxes.

Table 1: Bahrain's economic outlook

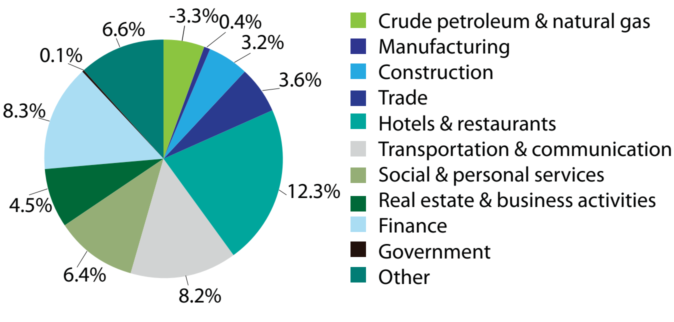
	2015	2017f	2018f	2019f
Real GDP growth, %	3%	2.5%	2.4%	2.2%
Non-hydrocarbon sector	3.7%	3.7%	3.7%	3.7%
Hydrocarbon sector	-0.1%	-0.1%	0%	0%
Nominal GDP growth, %	2.4%	6.8%	6%	5.1%
Inflation (CPI %)	2.8%	1.8%	3%	3%
Current account (% of GDP)	-4.6%	-3.8%	-3.8%	-3.8%
Fiscal balance (% of GDP)	-13.5%	-8.8%	-7.4%	-6.4%
Arabian medium crude oil (US$)	43	52	55	55

Source: Bahrain Economic Development Board, Bahrain Economic Quarterly Report, June 2017

The real GDP growth is expected to average 2.2% a year in 2017-18, as low oil prices continue to impact on government consumption, the Economic Development Board (EDB) of Bahrain reported.

Despite increasing competition from emerging financial centers in the region, the Kingdom continued to enhance its regulatory and investment framework with innovative strategies, which were largely shaped by pioneering new legislation in the rising fintech space.

Chart 1: Year-on-year growth for key sectors in Bahrain in first quarter (Q1) of 2017



Source: Economic Development Board, Bahrain Economic Quarterly Report, June 2017

The past year has been littered with a series of awareness events and industry briefings about the opportunities and challenges that surround this new industry.

Review of 2017

Historically, the Kingdom of Bahrain has long realized the need for diversification of its economy and accordingly, the composition of the non-hydrocarbon sector in the country's GDP increased from less than 60% in 2000 to about 80%, according to an Islamic International Rating Agency report.

In support of this view, the EDB reports that the Bahraini economy has continued to display remarkable resilience with the non-oil sector growth accelerated in the opening months of 2017, and the non-oil sector expanded by an annual 4.4% in real terms during the first three months of 2017.

It also reported that inflationary pressures are expected to increase in the coming year, with the implementation of value-added tax in 2018 finally agreed.

Non-oil growth accelerated sharply from the end of 2016. The fastest growth was recorded in hotels and restaurants, financial services and transportation and communications.

> "Economic activity will largely be shaped by a combination of continued strong infrastructure projects and public sector rationalization"

Financial services

The financial services sector built on its strong performance last year and expanded by an annual 8.3%. This compared to an annual rate of 5.2% in 2016. Transportation and communications was the third-fastest growing sector of the economy with an annual real growth rate of 8.2% in Q1.

Given that the financial sector is such a large part of the economy, contributing 16.7% of real GDP in 2016, the authorities put a high priority on regulation and governance.

Banking and Islamic finance

The banking sector continues to perform well, representing 6.2 times of GDP. The capital-adequacy ratio in the sector was reported to be 19.6% in September 2016, well above central bank requirements.

Key regulatory and practice development

There were some key regulatory and practice developments as follows:

- The Central Bank of Bahrain (CBB) released a new Shariah governance module which introduced an Independent External Shariah Compliance Audit (IESCA) and the first IESCA report is to be issued in 2020 based on the transactions, structures and activities of 2019.
- Likewise, the CBB announced new regulations to create a regulatory sandbox that will allow start-ups and fintech firms to test and experiment their banking ideas and solutions.
- Small and medium-sized businesses will be able to raise conventional or Shariah compliant financing through online portals according to the new fintech regulations.
- AAOIFI introduced new guidelines for the application of the Shariah compliant finance law. Four new standards were developed to help scholars assess and vet on Shariah compliance of the institutions' financial activities.

Preview of 2018

Given the prolonged reduced oil revenue that shapes GCC economies and the fiscal constraints of Bahrain's budget, the government will adopt policies to engage the private sector in funding projects and helping to achieve the desired growth rates.

It is also envisaged that the strategy of embracing innovative technology in relation to the fintech landscape will hopefully help the Kingdom to secure a leading edge in inward investment.

The EDB reports that economic activity will largely be shaped by a combination of continued strong infrastructure projects and public sector rationalization. This will be supported by a major build-up in activity via the GCC Development program as well as other investment projects, reported the EDB.

Conclusion

The years ahead will continue to be of importance to the private sector and the government has strategically emphasized greater contribution. The Economic Intelligence Unit predicts that the role of the private sector will grow gradually in the years from 2019-21, supported by the passage of a public-private partnership law.

Islamic finance marches ahead in Bangladesh

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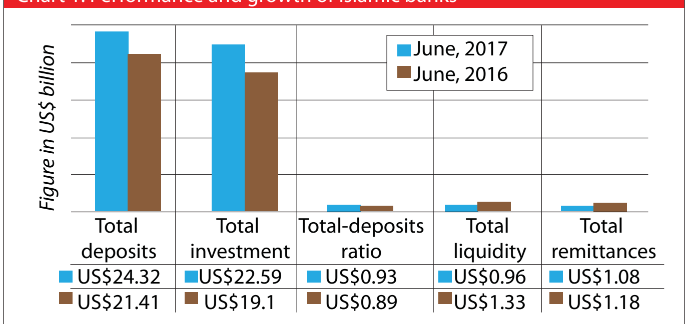
Bangladesh is a country of 170 million people and 90% are Muslims. The Islamic financial system started its journey in Bangladesh in 1983 and it has been growing rapidly ever since. Its present market share is more than 20% of the country's total banking industry.

Besides banking, other segments of Islamic finance like non-bank financial institutions and Takaful are also enjoying strong demand from customers and shareholders. In terms of the size of assets, Bangladesh occupies 12th position in the global Islamic banking rankings. Islamic banking has been making significant contributions to the process of poverty reduction and economic development of the country. Public demand for Islamic banking and its market share are growing rapidly.

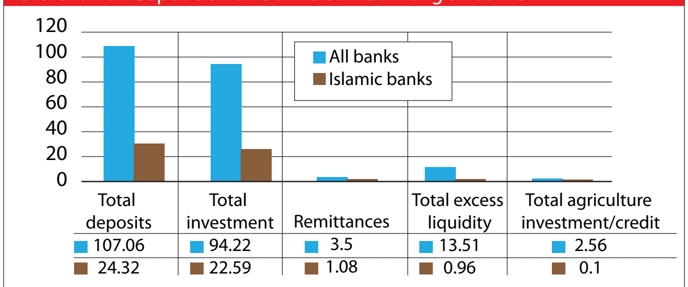
Islamic finance has gained ground in the past three decades in terms of financial inclusion, channeling untapped resources for national development in different sectors like industry, trade, agriculture, SMEs, microfinance, employment generation, poverty alleviation, corporate social responsibility (CSR), green financing and such.

Chart 1: Performance and growth of Islamic banks



Source: Author's own

Chart 2: Market position of Islamic banks among all banks



Source: Author's own

Review of 2017

With a domestic market share of more than one-fifth, a market share of one-third of global Islamic banking customers and a 50% market share of global Islamic microcredit, Bangladesh has the potential to be an important center of Islamic finance and banking on the global map with the help of competent leadership, incentives and appropriate branding.

Currently, eight fully-fledged Islamic banks are operating with 1,112 branches in the country. In addition, 19 Islamic banking branches of nine commercial banks and 25 Islamic banking windows of eight commercial banks are also providing Islamic financial services. With a workforce of 30,336 people, Islamic banking has a 22.72% market share of the country's banking sector in terms of deposits and investments.

Surplus liquidity of conventional banks declined compared to the previous year but Islamic banks in Bangladesh have an excess liquidity problem as they cannot invest in interest-bearing government treasury bills and bonds.

Islamic banks undertake and implement various types of social programs under CSR activities. Sources of funds include Zakat, penalty and compensation. These funds are spent for education, training, health and charity. The total expenditure on CSR activities for the Islamic banking industry stood at BDT600.8 million (US$7.22 million) in June 2017, an increase of 24.11% compared with the previous year.

Capital market
The Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE) have separate Shariah indices with a list of Shariah-permissible securities for Shariah compliant trading in capital markets. The DSE Shariah Index contains more than one-third of 293 companies and there are 128 companies under the CSE Shariah Index effective from the 29th October 2017 that are Shariah permissible securities in the capital market industry.

Money market
The Islamic money market in Bangladesh is at a nascent stage. The government has introduced Sukuk facilities known as Bangladesh Government Islami Investment Bonds and also the Inter Islamic Fund Market and Islamic Refinance Fund Account have been established but these are not yet vibrant.

Islamic non-bank financial institutions
There are two non-bank financial institutions (NBFIs) in Bangladesh, namely Islamic Finance and Investment and Hajj Finance, for Shariah-based transactions in different sectors of trading, manufacturing, servicing and leasing in the financial industry. These two Islamic NBFIs represent more than 3% of assets among 33 companies.

Microfinance
Islamic microfinance is offered as an alternative to aid poverty alleviation by employing both charity and profit. Bangladesh has a small Islamic microfinance market comprising four Islamic banks, 20 small Islamic microfinance institutions and an Islamic microfinance program of a conventional microfinance institution. The Association of Muslim Welfare Agencies in Bangladesh works as fund provider. Four Islamic banks are also mandated by the central bank for Islamic microfinance activities where they have licenses from the Microcredit Regulatory Authority. Islami Bank Bangladesh is the largest provider of the Islamic microfinance sector in Bangladesh with an approximately 80% share of the Islamic microfinance market due to the success of its Rural Development Scheme launched in 1995.

Takaful
Shariah-based Takaful services have also been contributing to Islamic finance in Bangladesh since 1999. Presently, eight Family Takaful (life insurance) companies and three General Takaful (non-life insurance) companies are providing Shariah-based products and services in the country under the supervision of the Insurance Development and Regulatory Authority. Moreover, a dozen traditional insurance companies are also offering Shariah compliant products and services to customers through specialized windows and projects. The volume of assets of this segment stands at approximately more than US$1 billion which is nearly 20% of the insurance industry.

Preview of 2018

Shariah scholars and researchers opine that all Islamic banks should strictly follow Islamic principles to achieve the objectives of Shariah. Islamic banks should provide financial services on the basis of risk-sharing like Mudarabah and Musharakah.

Though all Islamic banks have their own Shariah supervisory committee and there are central Shariah boards for Islamic banks and Islamic insurance in Bangladesh, there should be an independent Central Shariah Supervisory Council in the central bank, Bangladesh Bank, for the proper auditing and monitoring of Islamic banks' operations in accordance with Shariah principles.

Many conventional banks have applied to the central bank for a license to convert into an Islamic bank. The central bank, however, has refrained from giving permission until it has framed a comprehensive regulatory framework for the strict monitoring of Islamic banking.

To date, there is no complete Islamic banking law to control, guide and supervise this sector except the inclusion of some Islamic banking provisions in the existing Banking Companies Act and the introduction of a Guideline for Islamic Banking in November 2009.

"The Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE) have separate Shariah indices with a list of Shariah-permissible securities for Shariah compliant trading in capital markets. The DSE Shariah Index contains more than one-third of 293 companies and there are 128 companies under the CSE Shariah Index effective from the 29th October 2017 that are Shariah permissible securities in the capital market industry"

Conclusion

The Islamic banking and finance industry in Bangladesh is a significant contributor in terms of encouraging economic growth and generating employment in the country. The Islamic banking industry has a market share of more than 23% and the aforementioned 30,336 employees have been playing a very important role in mobilizing deposits and financing in the real sector industries, services and other key sectors of the economy and collecting 30.88% of total foreign remittances in Bangladesh.

The Islamic finance and banking sector of the country may conduct some empirical research and surveys to redesign investment policies, with more attention paid to research and development to devise proper guidelines and policies to promote investments under Mudarabah and Musharakah modes. Islamic banks may explore new Shariah-based financial instruments for better liquidity management. As Shariah is the backbone of the Islamic banking and finance industry, a comprehensive Islamic legal infrastructure with a solid foundation and commitment is necessary to help expedite the Islamic financial industry in terms of ensuring human welfare.

Islamic economy and finance in Bosnia and Herzegovina: Its best to come

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Despite its small population of about 3.8 million citizens and a not-so-big market for financial activities, Bosnia and Herzegovina, as one of the rare Muslim-majority countries in Europe, is an attractive market for the development of Islamic finance. The high growth rate of investments and tourist visits from the Middle East give additional push and opportunities to the development of the Islamic finance industry.

Review of 2017

In fact, the implementation and development of Islamic finance in Bosnia and Herzegovina started in 2000 with the establishment of Bosna Bank International (BBI), the only Islamic bank in the country until today. The major shareholders of BBI are the IDB, Abu Dhabi Islamic Bank and Dubai Islamic Bank. Throughout the years, BBI has overcome various challenges related to state law regulations and compliance with Shariah principles, the education of workers and market challenges. BBI currently offers a number of banking products that are similar to commercial banking and in compliance with Islamic banking principles.

In the last three years, the IDB and major shareholders pumped in an additional EUR30 million (US$35.31 million) as capital into BBI for business growth. Today, BBI's total assets stand at EUR450 million (US$529.65 million). The net profit for the bank in 2016 was EUR3.3 million (US$3.88 million), which increased more than 15% compared with 2015.

Over the years, BBI has developed various programs that have had a positive impact on the development of small businesses. Trust Fund is one of the 10 successful microfinance programs implemented by the IDB together with BBI and the Islamic community in Bosnia and Herzegovina, as well as the OIC Fund for Returnees.

The total deposits of the citizens of Bosnia and Herzegovina, as of September 2017, have risen significantly to EUR5.7 billion (US$6.71 billion). According to IMF predictions, Bosnia and Herzegovina would achieve a GDP growth rate of 3.2% in 2017 and in the following years would overcome the actual GDP growth rate.

Ongoing reforms under the government program called 'Reform's agenda' are in place to improve the current environment to make it suitable for investment and business in the country. According to the latest World Tourism Organization report, Bosnia and Herzegovina is ranked sixth among countries with the highest growth rate of tourist visits globally, with a 26% growth rate, which is four times higher than the average for European countries. It should be mentioned that in the last five years, the highest achievement has been noted in the number of tourist visits from the Middle East that has opened up new opportunities for Islamic finance services and the Halal industry.

The constant growth of the collection of Zakat and the development of Waqf properties within the Islamic community in Bosnia and Herzegovina in the last 10 years have also contributed to the development of the Islamic finance industry. One of the positive signs and recognition of the development of Islamic finance in Bosnia and Herzegovina was the award 'Golden bank in Bosnia and Herzegovina 2017' that was given to BBI by Swedish analytics house Bisnode. According to Bisnode analysis, BBI is a leader in the successful use of internal and external potentials and resources among banks in Bosnia and Herzegovina.

BBI, as a leader in Islamic finance in Bosnia and Herzegovina, in 2017 achieved growth in all the main business parameters. The major characteristics of the Islamic banking sector in Bosnia and Herzegovina in 2017 were the least risk of negative impact on corporate clients; the constant growth of new clients, employees and portfolios and the high effectiveness of asset management. BBI was also awarded 'The best Islamic bank in Europe' award by Cambridge IF Analytica in a ceremony held in Dubai in November 2017.

Preview of 2018

In 2018, it is expected that there will be further growth and development of the Islamic finance sector, headed by BBI, that will follow ongoing significant investments in Bosnia and Herzegovina, including investments in the energy sector such as thermal power plants in the Tuzla region, the construction of a major highway and other infrastructure projects in the country, as well as investments in real estate, tourism, agriculture and other industries. The success of the Sarajevo Business Forum, organized over the years by BBI and partners, could bring more successful stories directly connected to Islamic finance. The constant growth of the Islamic finance industry is followed by conferences and courses organized by key players in the industry, in order to strengthen and improve the position of Islamic finance in the market.

Conclusion

More and more reputable companies and business leaders in Bosnia and Herzegovina recognize the advantages of Islamic finance that bring necessary stability and prosperity to their businesses and asset management. The aforementioned facts, including the emerging interest of foreign investors, can bring new opportunities for the development of the Islamic economy and finance in Bosnia and Herzegovina.

Islamic finance in Brunei Darussalam

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Brunei Darussalam's Vision 2035 aims to successfully develop the country's financial services sector and compete with developed regional competitors. By 2035, it is hoped that the financial sector is able to contribute at least 8% of the national GDP. Recent statistics by the Department of Economic Planning and Development show that the financial sector contributed around 5.1% of the Bruneian economy.

To achieve the goals of Vision 2035, Autoriti Monetari Brunei Darussalam (AMBD) recently published the Brunei Darussalam Financial Sector Blueprint 2016-25 (FSBP) that outlines the framework and measures to develop the financial sector. The FSBP identifies five key pillars that form critical components of a sustainable financial ecosystem, including competitive and innovative financial institutions and services. An area that Brunei views as a key driver of growth within the financial services sector is Islamic finance, in particular as Brunei has strengths that can be leveraged on, including its strong economic and political stability.

Review of 2017

In the last few years, the Islamic finance sector in Brunei has seen significant growth. In the banking sector, as of the second quarter (Q2) of 2017, Islamic banking assets accounted for 61.8% of the total market share of assets (BN$17.3 million (US$12.73 million)) while in the capital market sector, the share of the Islamic fund market has expanded from 31% in Q2 2015 to 50% in Q2 2017. This significant growth is reflected in the ICD-Thomson Reuters Islamic Finance Development Report 2016 which included Brunei in its Top 15 Performers list, ranking Brunei 14th out of 124 countries.

As the central bank, AMBD intends to further promote Islamic finance in Brunei to bolster the achievement of Vision 2035.

Having said that, Brunei cannot escape the challenges of Islamic finance faced by other countries across the globe, among others including the different interpretations in cultures, domestic needs and regulations. Thus, this calls for the need to strengthen Islamic finance policy legislation, dispute resolution, as well Shariah financial standards. To this end, AMBD has taken numerous strides to align the current regulatory framework to meet international standards and best practices such as the implementation of Basel Core Principles for Effective Banking Supervision and Basel II by 2020 which can help in strengthening the resilience of the banking sector as well as meeting AMBD's objective of ensuring financial stability.

Furthermore, the financial institutions in Brunei, both Islamic and otherwise, have excess liquidity, which needs to be addressed by exploring how to convert them to real economic activities.

Another challenge Brunei faces in developing Islamic finance is in producing more quality human resource in multiple disciplines such as Shariah, legal, finance and other related disciplines. Even though Brunei is within the top 10 in the research subindicator in the Islamic Finance Development Index, more quality research is needed as it is seen as a key factor in providing a clear direction for policymakers and increasing product innovation.

Finally, the Islamic Finance Development Index has set Brunei's awareness index at 10, with 31 news items and no conferences and seminars. While the industry has grown very rapidly, there is still

room for Brunei to increase awareness of Islamic finance products and services available in the country.

Improvements have been seen in this area with the launching of the Brunei Darussalam Islamic Finance website and smartphone application which serve as a gateway to Brunei's Islamic finance with information on its comprehensive end-to-end regulation, the market players and their products, the people who drive this development and the education and training available for continuous professional development.

Preview of 2018

Moving forward, the FSBP outlines strategies that will elevate the reputation and quality of Islamic finance in Brunei. Policy directions in this area include the following:

- Developing a secondary market for government Sukuk through a securities exchange, to provide institutional and retail investors with alternative investment opportunities
- Developing a Shariah governance framework, to help ensure that the structure, processes, products and services of Islamic financial institutions are in accordance with Shariah principles
- Considering the use of alternative distribution channels, including the use of technology in improving efficiency and access to Takaful products and services
- Structuring the fund management industry around core propositions that leverage on Brunei's competitive advantages, such as an Islamic fund hub offering Shariah compliant products and sustainable, responsible and impact investing;
- Introducing more innovative Shariah compliant financial products and services to meet the more diverse global demands for Shariah compliant financial institutions, and
- Cultivating local talent for the purpose of expanding the pool of Islamic scholars so that there is orderly succession planning.

Conclusion

While Brunei has traditionally relied on the oil and gas sector as a major source of revenue and economic growth, the decline in oil and gas prices in recent years make it even more important now for Brunei to accelerate its diversification measures.

AMBD, in collaboration with various government ministries and agencies, as well as the financial industry, is working toward the growth of the wider economy by leveraging on its niche areas such as Islamic finance.

Innovative firms taking the lead in Islamic finance

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2017 was a landmark year for Islamic finance in Canada as several innovative financial firms launched their operations there. With an estimated population of 1.5 million and one of the fastest-growing segments in Canada, the Canadian Muslims present a significant growth area for Canada's financial sector. There has been a significant increase in the number of mosques, Islamic schools and Islamic centers in Canadian cities due to the large growth in Muslim immigration in the past decade. The Canadian Muslim community is young, has a high level of education attainment, as well as large families with high saving rates.

Some observers believe that Canada has a number of advantages that make it well positioned to become a North American hub for Islamic banking. This include a growing Muslim population, a stable banking system and a favorable regulatory environment. There appears to be significant room for growth in a number of areas including mortgages, insurance and investment funds.

A number of surveys indicate that a strong majority of Canadian Muslims are seeking Shariah compliant alternatives to conventional financing. Research from the Rotman School of Management within the University of Toronto has estimated the Muslim residential home finance market alone to be nearly US$30 billion in Canada.

Review of 2017

Significant developments in Canada in the field of Islamic finance over the year 2017 included the launch of a Shariah compliant robo-advisory investment product, activities of GCC-based Islamic investment banks in the Canadian market and the introduction of new Islamic finance firms in Canada..

Robo-advisor Wealthsimple launched a new investment portfolio for Canadian Muslims. The company partnered with stock analysis company MSCI and its committee of Shariah scholars to design the all-equity Shariah compliant portfolio. This portfolio includes 50 stocks designed to maximize diversification and closely track the MSCI ACWI Islamic Index. The low fees of this platform are meant to counter the relatively high management fees associated with current Shariah compliant funds in Canada.

The largest Canadian Shariah compliant funds in terms of assets under management continue to be the bullion funds managed by the Bullion Management Group. The BMG Bullion Fund is a long-term real wealth preservation fund. It has a fixed investment policy of purchasing equal dollar proportions of uncompromised allocated and insured gold, silver and platinum bullion.

The next largest fund would be the Global Iman Fund owned by Global Growth Assets. The fund is managed by UBS and is based on the Dow Jones Islamic Index.

The real estate boom in Canada has continued though there has been a recent slowdown due to a number of new lending restrictions introduced by provincial and federal governments. This has opened large investment opportunities as a lot of real estate developers are receiving strong returns on their deployed capital. One such developer is the Everest Group of Companies which is launching Shariah compliant real estate investment funds for Canadian and international investors.

In addition to these investment funds, there are several Shariah compliant mortgage products that continue to operate in the Canadian Islamic finance market. On the commercial finance side, there have been several Shariah compliant financings for the purchases of Islamic centers, Islamic schools and commercial properties for Muslim businesses. These financings were done by Canadian financial institutions including several major credit unions and were primarily on a select basis and not offered to the general public.

The Rotman School of Management within the University of Toronto is Canada's leading business school and continues to provide a leadership role in Islamic finance education. It introduced Canada's first MBA course in Islamic finance, which is now entering its sixth year and has been a top-ranked course since its inception. A number of graduate students have participated in research on Islamic finance-related topics. Other universities and colleges are taking the University of Toronto's lead and beginning to offer courses in Islamic finance and economics.

2017 witnessed the launch of significant business activities by Alawwal Group out of Saudi Arabia. Alawwal is focusing on real estate investment activities in Canada as well as supporting the growth of Islamic finance in Canada. The newly formed Manzil group will focus heavily on residential real estate financing with the launch of their mortgage fund.

Preview of 2018

It is expected that there will be considerable developments in Islamic finance in 2018 as marketing and distribution of Shariah compliant products become more widespread. There is also the expectation that retail mortgage and car financing products may still be launched by some of the leading Canadian financial institutions.

Conclusion

Canada continues to become more attractive to foreign investors and there has been interest by some global Islamic financial institutions to establish a presence in the country. 2018 will likely see a number of new players establishing themselves in this relatively new market segment in Canada.

China's foreign trade to the new opportunities and challenges in 2018

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The reform and development plan outlined by the 19th National Congress of the Communist Party of China in Beijing recently will inject new vigor into China's economy and trade. And the Belt and Road initiative is expected to create broad channels for the development of foreign trade with the additional amendment that will see the following statement written into China's constitution: "Following the principle of achieving shared growth through discussion and collaboration, and pursuing the Belt and Road initiative." The constitutional inclusion of the Belt and Road by name is a major step toward solidifying the initiative as a core plan of action that is to be carried out long into the future.

Review of 2017

While Chinese foreign mergers and acquisitions have rapidly dropped 42% year-on-year overall, investment along the Belt and Road continues to boom. So far in 2017, at the time of writing, China has made 109 deals worth US$33 billion in Belt and Road countries, topping the US$31 billion that was spent in 2016, according to Reuters.

The relevant departments of the Ministry of Commerce published a report on China's foreign trade in Beijing on the 6th November. The report indicates that in the first three quarters of this year, thanks to the rising demand at home and abroad, supportive policies and the speeding-up of industrial upgrading, China's total export-import value hit CNY20.29 trillion (US$3.06 trillion), up 16.6% year-on-year, with the trade surplus down 17.7% year-on-year to CNY2.03 trillion (US$305.66 billion).

The Belt and Road projects strengthen China's economic and trade ties with the countries along the routes, and China's trade with those countries in the first three quarters rose 20.1%, year-on-year. Key trading growth areas have been recorded with ASEAN, India, Russia and Central Asia.

> "The Belt and Road initiative will improve connectivity and modernize transport links, bringing more ASEAN export products to the fast-growing Chinese consumer market"

For the direct participation of Islamic finance, the government of the Hong Kong Special Administrative Region of the People's Republic of China successfully offered its third Sukuk under the Government Bond program. The Sukuk facility, with an issuance size of US$1 billion and a tenor of 10 years, is the third US dollar-denominated Sukuk launched by the HKSAR government, subsequent to the issuances in September 2014 and June 2015. It was a landmark transaction since Hong Kong is the first 'AAA'-government to launch a Sukuk paper with a 10-year tenor. Compared with the five-year tenor of the past two Sukuk, this latest 10-year Sukuk have extended the yield curve, setting an important new benchmark for potential issuers in Hong Kong and globally, according to the official website of the Hong Kong Monetary Authority .

Chinese corporations are seen raising funds through Islamic bonds in Malaysia, which has positioned itself as Islamic funds hub. In July, China-owned Edra Power Holdings's solar energy unit Tadau Energy announced it had issued up to RM250 million (US$60.22 million)-worth of sustainable responsible investment Sukuk, the first green Sukuk issued in Malaysia. And prior to that, Chinese Beijing Enterprises Water Group's subsidiary, BEWG Malaysia, made its debut in the Malaysian Sukuk market by issuing RM400 million (US$96.35 million)-worth of Islamic medium-term notes, the first-ever ringgit-denominated Sukuk involving water infrastructure by a Chinese state-owned enterprise.

Chinese property giant Country Garden's Malaysian unit, Country Garden Real Estate, was the first Chinese company to issue Islamic bonds in Malaysia. In 2015, the group made sold a debut Sukuk paper from a RM1.5 billion (US$361.31 million) program. Malaysia's Sukuk market accounted for 41.1% of the total global Sukuk market of US$72.9 billion in 2016, according to RAM Rating Services.

Last year, Malaysia's outstanding domestic Sukuk market stood at RM661.9 billion (US$159.43 billion), 8.78% higher compared with the RM608.5 billion (US$146.57 billion) in 2015. It was also 29.03% higher when compared with the total outstanding domestic conventional bond market of RM513 billion in the same year.

> "Low-profile development and participation in Islamic finance in cross-border transactions between China and Muslim-majority countries are more realistic"

As for the MENA region, the China-Arab States Expo in September in Ninxia, Yinchuan, drew representatives from 47 countries and regions. The four-day event covered trade in commodities and services, as well as cooperation in technology, investment and tourism. The Belt and Road initiative was highlighted during the expo, and forums on high-speed railways, logistics and credit were staged.

A total of 321 deals related to science and technology, finance, energy, agriculture, health, tourism, culture and education were inked during previous events, with total contracts worth tens of billions of US dollars.

China-Arab trade reached US$171.14 billion in 2016, and agreements on projects worth US$40.37 billion were signed between the two sides, up 40.8% from 2015. China's non-financial direct investment in Arab countries surged 74.9%.

As for ASEAN, the emphasis on creating better-connected economies to help facilitate trade and investment is extremely important and will help ASEAN maximize opportunities within the region as well as those stemming from the China-proposed Belt and Road initiative, which is key to achieving ambitions to double bilateral trade between China and ASEAN to US$1 trillion by 2020.

ASEAN's combined GDP hit around US$2.4 trillion in 2016. As a single entity, it was the sixth-largest economy in the world last year. The importance of the Belt and Road initiative for ASEAN countries is evident as infrastructure is key to boosting the competitiveness of the region, said an economist. A recent report by the United Nations Conference on Trade and Development showed that ASEAN would

need infrastructure investment of US$60-146 billion per annum until 2025.

China is providing assistance in rail infrastructure projects to many ASEAN countries, including Indonesia, Thailand, Malaysia, Cambodia, the Philippines and Laos. Improved transport links between ASEAN and China will also help ASEAN's manufacturing industry become more closely integrated with the Chinese manufacturing supply chain. The Belt and Road initiative will improve connectivity and modernize transport links, bringing more ASEAN export products to the fast-growing Chinese consumer market.

Major rail lines that are under construction or will be developed under the Belt and Road initiative will increase volume and efficiency of intra-regional trade, and promote the productivity of the region with more efficient transportation, said HSBC Bank Malaysia's CEO, Mukhtar Hussain.

Preview of 2018

The IMF has revised China's growth outlook compared to 2016's report. Growth between 2017 and 2021 is now expected to average 6.4%, compared with 6% in 2016. China's foreign trade will face new opportunities, as well as challenges next year. With the expediting of economic restructuring, the positive fundamentals of China's foreign trade will remain unchanged. More Chinese mainland-related Sukuk issuances, especially those with projects and underlying assets overseas in Muslim countries, will likely be witnessed.

Conclusion

Given India's recent halt on proceeding with Islamic banking in the country, the sensitivity of the issue in China is not to be overlooked, thus low-profile development and participation in Islamic finance in cross-border transactions between China and Muslim-majority countries are more realistic and possible to be witnessed. However, there are concerns like tax and cost neutrality and regulatory frameworks that need to be addressed to enable a systematic development of Islamic finance in mainland China and even for cross-border markets.

Egypt looks ahead to economic recovery via Islamic finance in 2018

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Islamic financial services are expanding worldwide. With more than 200 Islamic financial institutions, some expect Islamic finance to attract 40%t of the total savings of the Muslim population worldwide. Egypt pioneered Islamic finance with the 1963 establishment of Mit Ghamr Savings Association. Notwithstanding its early start and Egypt's large, predominantly Muslim population, Islamic financial services have only had limited penetration, with just three major fully-fledged Islamic financial institutions and some Islamic windows at conventional banks.

Egypt has over 90 million people, with over 90% of those Muslims, and it also has significant natural resources. This combination of a large Muslim population and natural resources suggests that Egypt should be a leading market for Islamic finance. However, the market is still underpenetrated.

Review of 2017

AAOIFI held its first-ever public hearing in Egypt concerning its new Shariah governance and ethical standards in October with the cooperation of the Egyptian Islamic Finance Association. The hearing covered three important standards: the sale of debt; the external Shariah audit; and the Shariah compliance function at Islamic financial institutions. The event was well attended and attracted very interactive discussions of the new standards by a diverse audience that came from different parts of the Islamic finance industry, including regulators, bankers and Shariah scholars. During the first quarter of 2017, Takaful firms had a nearly 9% share of Egypt's insurance market. Egypt's minister of public sector affairs, Ashraf El-Sharkawy, announced in August that Egypt's first government-owned Takaful insurance company is expected to start operations at the beginning of 2018. The government also attempted to regulate the issuance of Sukuk from public and private entities by approving amendments to Law No 95 of 1992 of the Capital Market Law, including recommendations to repeal the 2013 Sukuk Law that was never implemented.

The government declared that the objective of issuing the new Sukuk Law is to provide new investment channels for the Egyptian capital market and new financial tools to local and foreign investors.

The IDB and the Islamic Corporation for the Development of the Private Sector will participate in the financing of the North African country's largest and first-of-its-kind grid-connected solar power park comprising six solar photovoltaic power plants in the Benban Solar Park in Aswan in Upper Egypt.

The financing consortium also includes EBRD, the UN's Green Climate Fund and Dutch development bank FMO. After completion, Benban will be the largest solar installation in the world with a planned total capacity of 1.8 GW. The six solar plants, totaling 400 MW at an estimated cost of US$450 million, will offset around 350,000 tonnes of CO_2 emissions per year, supporting Egypt's emission reduction targets under the Paris Climate Agreement.

Preview of 2018

In 2016, Finance Minister Hany Kadry Dimian stated that Sukuk regulations will be introduced that year. This year, the government

amended the current Capital Market Law and recommended to repeal the 2013 Sukuk Law. The government is expected to go further in the regulation of Sukuk in 2018 and provide Sukuk with an entirely new and stronger regulation, which would encourage the development of Islamic finance in Egypt and have a positive impact on the market. But before that, the Egyptian government needs to make sure that Sukuk regulations are responsive to market demands; issuing the long-awaited Sukuk regulations would be an important step for Egypt, allowing the Egyptian corporate sector to get access to a new pool of investors, and Egyptian financial institutions to capture new market share in the Shariah compliant industry.

Dr Mohamed El-Beltagy, the chairman of the Egyptian Islamic Finance Association, stated that he expects the volume of Islamic banking to grow from its current value of almost 10% to 15% by 2020 but this growth of Islamic finance in Egypt might be impeded by any upcoming devaluation and depreciation of the currency which would have a marked impact on the Islamic finance industry, as a consequence of the IMF loan. On the other hand, according to the Finance Ministry, foreign investments in securities rose up to US$18.8 billion dollars a year after the devaluation and the IMF expects that the Egyptian economy will grow by 4.5% in 2018.

Conclusion

Although the growth of Islamic finance in Egypt relies heavily on the economic circumstances of the country, governance and regulation also play a significant role. Consequently, banks have compensated for the legislative void in Egypt by adopting international Shariah governance guidelines, such as those of AAOIFI. Policymakers, professionals and academics are aware of the corporate governance challenges that Islamic financial institutions are facing in Egypt. The general belief is that instituting an appropriate and solid legal and regulatory framework will create an enabling environment that supports the growth of the Islamic financial services industry and as well fosters its stability. This is the reason why many organizations are working to develop standards and provide best practices to Islamic financial institutions.

Islamic finance to emerge as an opportunity in France to get the best out of finance

Anass Patel *is president of 570easi. He can be contacted at anass.patel@groupe570.com.*

France elected a new president in 2017 – a new young president below 40! We want to believe that it is a new page for the relative young French Islamic finance industry, centered around the retail market. Maybe a late emergence that would benefit from the rise of fintech?

Review of 2017

Islamic finance in France is still perceived as a niche market in 2017. Only a few players are battling it out on the ground, making the most of alternative finance, in three main categories as follows:

Crowdfunding

Financement Participatif France, the representative professional association of the crowdfunding sector, states that in Europe, alternative finance experienced a booming growth of 92% and reached EUR5.4 billion (US$6.39 billion) in 2015. In France, in 2016, nearly EUR235 million (US$278.23 million) was collected by crowdfunding platforms, a growth of 40% of funds raised in one year, according to the French Barometer of crowdfunding 2016 report by KPMG.

Back in 2014, when the first amendments opened up this new market, different Islamic crowdfunding platforms were launched (Aoon, Musulman-Participatif, etc), but only Easi Up, the education-focused platform is still active with a new positioning from mid-2017, both on social crowdfunded projects and money pots (the dialogue campaign is a French project run both on Easi Up and on LaunchGood). It is interesting to note as well that CotizUp is a newly launched moneypot platform by Muslim entrepreneurs, though not claiming to be an Islamic platform.

Home finance

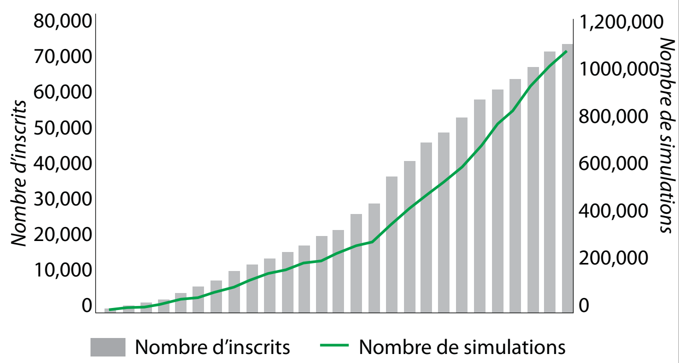
Mortgages is clearly the most visible segment thanks to a few banks operating in the market mainly through an Islamic window principle powered by a white label model provided by 570easi. Some interesting traction can be seen on this unique digital mortgage platform, attracting many members, each day getting 600 mortgage simulations online, with the following latest statistics aimed at convincing banks to translate the online mortgage requests into potential loans from Francophone clients (France, Belgium and Luxembourg):

- One million-plus mortgage simulations have been reached, making its online simulator a unique feature of the customer journey.
- Around 75,000 members are registered on the platform, with more than 100 eligible requests received each month, half of which are getting through the risk-scoring model leading to a mortgage offer letter.
- Approximately 1,000 mortgages have been offered which amounts to EUR200 million (US$236.8 million), still small compared to the potential of the market (in billions) but it is interesting to note that this was possible thanks to around 30% of downpayments contributed by the retail customers, ie a good EUR35 million (US$41.44 million) was sitting in bank deposits.

Savings and insurance

Despite the growth of the retail mortgage segment, Takaful companies have been quiet and most of the local initiatives have

Chart 1: Evolution of number of registered members and simulations (Left Y axis: Number of registered members; right Y axis: Number of simulations)



Source: Author's own

not been successful. As noted by Ezzedine Ghlamallah for Islamic Finance *news*, no general Takaful solutions exist for the extended 16 million European Muslims.

Thankfully, the only life insurance product available for the past two years from Swiss Life is still active – it is a unit-linked contract to the Salam Pax SICAV umbrella fund. As of mid-November 2017, around EUR12 million (US$14.21 million) was collected with online statistics from Morningstar showing the following details by subfund net asset value (fund size):

- Ethical Fund of Funds: EUR7.5 million (US$8.88 million), and
- Serenity Sukuk: EUR4.4 million (US$5.21 million).

In summary, approximately EUR200 million (US$236.8 million) has been funded by local banks and EUR50 million (US$59.2 million) contributed by retail savers; these are modest but encouraging data points to confirm the existence of a niche market that is searching to reach its full potential, a market that did not exist four years ago.

Preview of 2018

From different studies, the potential of the Islamic finance sector in France out of the six million Muslims is around 300,000 households, starting with home finance and savings as primary needs. The lack of retail savings products in France is a big missed opportunity for sure as some younger entrepreneurs are looking at how best to address this segment with collaborative strategies and putting the best of the online and physical world together.

Many reports are converging toward the need for Islamic finance to emerge as an opportunity to get the best out of finance and this is the reason why we believe that the future will be collaborative, both in terms of entrepreneurial projects and technological platforms. No doubt artificial intelligence, smart analytics and contracts, internet of things and such will be applied into new ways to address financial needs, putting at the core of the products a necessary ethos to preserve against fallacious claims or the zero-sum gains pitfall that still prevails among practitioners.

Conclusion

In 2018, doors will be open for alternative finance to bootstrap on mutual trust and market innovation. There is no better proposition regarding retail customers than to deliver a transparent and intelligent capital-matching between home buyers, deposit savers and retail banks with a clear disruptive Islamic fintech model.

Germany – emerging market for Islamic banking

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Islamic banking was first launched in Germany and in the eurozone in 2015 when the Federal Financial Supervisory Authority, BaFin, granted a full banking license under German law for the provision of deposit and credit business to KT Bank, the first bank with a Shariah compliant business model in the region. Despite the strenuous political climate in the country, driven by increasing right-wing tendencies and the refugee crisis, the market responded enthusiastically and was immensely curious of this then-unknown faith-based banking model. The media exposure about the pioneering first Islamic bank, with a well-known Turkish-Kuwaiti background, amounted to more than 1,500 publications in leading national news and business media. The bank itself registered an incessant flow of client inquiries.

The introduction of Islamic banking in a country like Germany seems to respond to needs arising out of the increased influx of Muslim immigrants. Germany, with its current Muslim population of around 4.7 million, is, alongside France and the UK, classified as one of the predestined western key markets for Islamic finance. During the last three years of operational business development and analysis of its value-based methodology, it became apparent that Islamic banking does not only fulfill the requirements of the Muslim community, but also the ethical standards of the majority of German society. The Shariah compliant finance model is currently being established as a new field of socially responsible investment (SRI), which is in high demand after the financial crisis. European markets are becoming increasingly aware of the universally ethical qualities of Islamic banking's Quran-based values, thus attracting value-conscious clients of all beliefs.

Review of 2017

In 2017, KT Bank officially declared the completion of the founding and establishment phase of the bank in the German market after two successful years of market introduction. The bank's key topics in 2017 were the achievement of a growing client base of Muslims and non-Muslims, an 80% asset growth and the further optimization of the process management as well as the development of the retail, corporate and institutional product portfolio and up-to-date services.

A focus was set on product competitiveness and diversity from advancing the variety of deposit products to offering refined Shariah compliant import financing products, which saw an increased demand from importers in the Halal food industry. The strategic enhancement of online infrastructures like account opening and the mobile banking app was also one of the main topics of the bank in 2017. Foreign currency transactions with major currency pairs and excellent exchange rates were introduced, and Germany's upward trend in the property market increased the call from GCC investors for Shariah compliant real estate opportunities. 2017 was also the year of expansion of Islamic banking to North Rhine Westfalia, which is the German federal state where most Muslims live. In addition to the three branches in Frankfurt, Berlin and Mannheim, KT Bank also opened its fourth branch in Cologne which is soon to be expanded.

Further, the historically low interest rate boosted the general appeal for investments into participation accounts, which had their profit-loss sharing scheme in the participation pool updated in 2017, in favor of longer terms and higher amount deposits and thus in favor of the client. The profit rates were, and are still, outperforming those of the conventional fixed deposit sector, thus making Islamic saving opportunities more attractive to all Germans.

Preview of 2018

KT Bank, Germany's first fully-fledged Shariah compliant bank, as of today remains the only financial institute to single-handedly evolve the Islamic banking segment in Europe. A steady growth course is being anticipated in 2018, with a financing portfolio of currently more than EUR100 million (US$116.13 million). The market will see a lot of new products and services, among them new developments in the Sukuk and Takaful area. One highlight will be the launch of a credit card with an installment option, a product unheard of in Germany that is running successfully in the Islamic banking sector in Turkey. It serves as an Islamic alternative to overdraft and is anticipated to also attract a lot of non-Muslim clients.

A traditionally important and Shariah compliant form of commodity investment for Muslims that is also gaining importance among commercial banking systems is physical gold collecting. With KT Bank's parent bank in Turkey running 20% of all gold accounts in the country, this expertise will be transferred into the German market in 2018 with the physical gold account as a new investment product featuring several gold savings plans. Another target in 2018 will be the further advancement of the Islamic online direct banking structure as there is strong demand from currently out of more than 70 countries to open Shariah compliant accounts in Germany.

Conclusion

Islamic banking in the eurozone has already proven to be an enrichment to western conventional business ethics within the finance industry and was acknowledged by the finance ministers of the G20 states for its positive effects on national economies and benefits to society. Post-financial crisis, the world community is generally more aware of value-based finance models, banking regulations and undue risk-taking. Islamic banking thus captures the contemporary economic zeitgeist and can help to shape a cultural change in the eurozone banking industry in favor of the SRI segment.

Hong Kong should consolidate leading position in Islamic finance without further delay

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Being one of the major international finance centers and freest economies for decades, Hong Kong is aware of the rapid growth trends and the importance of developing Islamic finance in its territory, particularly when looking to become the super connector of China and the rest of the world in terms of the 'One Belt, One Road' (OBOR) initiatives, and making itself the most all-rounded regional financial hub when competing with its top rival Singapore.

However, since 2007 when Islamic finance was first mentioned in the fiscal policy of Hong Kong, apart from the amendment of its profits tax and stamp duty legislation as well as three sovereign Sukuk issuances, not much have been done by the Hong Kong government, market practitioners and academics to promote Islamic finance development in Hong Kong. Facing this golden opportunity but with a slow response, it is suggested that Hong Kong should act to establish and consolidate its leading financial center position by boosting Islamic finance without any further delays.

Review of 2017

In February 2017, the Hong Kong government issued its third Sukuk (US$1 billion, 10-year tenor, Wakalah structure). It was a successful but long-awaited sovereign issue with an oversubscription of 1.7 times and subscribers were spread across the world and made up of mainly institutional investors. The issuance proved that Hong Kong is equipped with the regulatory and operation mechanisms in terms of Sukuk issuance. With a tested platform and successful examples of sovereign issues, the Hong Kong government aims to attract corporate issuers to utilize Hong Kong to issue their Sukuk in raising funds for promising projects in the APAC and MENA regions.

In March 2017, Paul Chan, the financial secretary of Hong Kong, briefly mentioned about Islamic finance in his fiscal policy speech, but no special or supportive measures were mentioned for the further development of this globally high-growth area. Since then until July 2017, two Chinese enterprises engaged in power and water industries, on separate occasions, have opted for Malaysia rather than Hong Kong to raise funds for their infrastructure projects via Sukuk totaling US$150 million – similar to what happened in December 2015 when Country Garden Group, the property developer giant of Guangdong that listed in Hong Kong, decided to use the Malaysian capital market for their debut Sukuk issuance to raise funds amounting to US$350 million under the Murabahah model.

Preview of 2018

While focusing on Sukuk as an initial step, and looking forward to further build up its Islamic banking as well as Takaful/re-Takaful sectors, it is believed that there are three critical drivers to boost Islamic finance development in Hong Kong in 2018.

The OBOR infrastructure projects which require Islamic financing are the first crucial catalyst for Hong Kong to be the super connector for China and OBOR countries. Hong Kong should capture the invaluable opportunities of Sukuk Istisnah for public-private partnerships (PPPs). PPPs can often result in infrastructure projects which have the most innovative designs, the most timely construction and the most cost-efficient operation.

The commonalities in the areas of green financing and Islamic finance are guiding the increasing supply of green bonds together with green Sukuk in the market, which are normally being issued to finance renewable energy and other environmental assets and which in turn are greatly supported by China's government under its 13th five-year plan. In other words, Hong Kong's efforts to develop a a green finance hub can simultaneously be an impetus for the development of Islamic finance. Green Sukuk is the key financial product to be promoted in both governmental and commercial sectors.

It is widely recognized that Islamic finance and the Halal industry are correlated and endogenous. The growing global demand for ethical ecosystems contributed to the rapid growth of the Halal industry in recent years. The Halal industry needs financing in a manner that would reveal the Halal concept, a unique position that is predicted to be handled by Islamic finance. Hong Kong should concentrate on playing its niche role in the Asian region, focusing on Shariah compliant trade financing for Halal products and services.

"Hong Kong's Islamic finance development will be positive if the Hong Kong government and market participants can inject more efforts into this promising field"

Conclusion

Under the leadership of Carrie Lam, the new chief executive of the Hong Kong government since her inauguration in July 2017, it is hoped that a clearer governmental direction and more supportive measures as well as concrete actions will be in place for the sustainable development of Islamic finance in the city. Apart from the existing Hong Kong Monetary Authority's Infrastructure Financing Facilitation Office and Financial Services Development Council's task forces, it is advisable for Hong Kong to set up an Islamic Finance Advisory Council under the Financial Secretary Office in order to install a team of appropriate personnel from governmental, commercial and academic sectors to formulate, promote and implement a series of feasible action plans on Islamic finance development in the long run.

In addition, there are a lot of areas for experience-sharing and collaborations if Hong Kong can work closely with countries like Saudi Arabia, the UAE and Malaysia, as well as make the best use of its role as an Asian Infrastructure Investment Bank member to proactively explore closer ties with the OIC, IFSB and AAOIFI. Enhancement of the regulatory and legal framework will be highly appreciated since a gradual development of a comprehensive set of Islamic banking, tax and Takaful legislation for Hong Kong is critical to the successful development of Islamic finance. If Hong Kong can host the World Islamic Banking Conference or other important Islamic finance summits as well as offer high-quality Islamic finance professional qualifications such as those by the International Center for Education in Islamic Finance, it will be very beneficial as long as there are some local applications and case study elements catering to Hong Kong and its neighboring countries. Taking all of the aforementioned as a whole, Hong Kong's Islamic finance development will be positive if the Hong Kong government and market participants can inject more efforts into this promising field.

A slow but promising path for Shariah banking in India

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The potential growth of Islamic banking in India is tremendous and although the benefits of Shariah banking cannot yet be taken advantage of by the Muslim community, it can be of great significance to other communities and corporates to avail financial services. It is estimated that almost 180 million Muslims in India are unable to access banking channels due to the non-availability of interest-free banking in India. Despite the visible need of financial inclusion of the Muslim community in India, the government has been rather lax in its approach to frame regulatory policies for Islamic banking laws.

Review of 2017

Various state governments in India have been working to provide for Islamic banking in their states. Recently, the Kerala government launched its first Shariah compliant banking institution called 'Halal Fayida Coop Society'. This was a welcome change from the Kerala government, as it acknowledged the need and benefits of a Shariah compliant banking system. In the state of Telangana, a 'sewa' or service center registered with the Mutually Aided Cooperative Credit Society, has seen a steady increase in its membership at a rate of 200-300 a month.

The Reserve Bank of India (RBI) in 2005 had reported that billions of rupees earned by way of interest were kept suspended in bank accounts in India. The RBI gathered that the monies which were left unclaimed in these accounts were accumulated by way of interest and also belonged to customers who were prohibited from claiming the same due to religious barriers. Recently, the State Bank of India (SBI) declined to respond to a Right to Information (RTI) query filed, justifying that it does not maintain such information in its database. The SBI also explained that this would be a long procedure and stated that it had a right to abstain from answering such a query under Section 7(9) of the RTI Act as the information to be provided would "divert disproportionately the resources of the bank".

Preview of 2018

India introduced the Insolvency and Bankruptcy Code, 2016 (the Code) to address matters of insolvency and bankruptcy. The Code has been partly effective since December 2016, and almost over 200 applications have been admitted by the adjudicating authorities under the Code. The objective of the Code is to clear the debt that has been piling up, and to provide an effective and speedy remedy to those seeking relief under the Code. The enactment of the Code will benefit offshore investors to invest in India as they would have security under the Code in case of any default.

The Code has been enacted to consolidate a multitude of laws on insolvency and bankruptcy, for the maximization of the value of assets, to promote entrepreneurship, to make credit available and to balance the interests of all the stakeholders, including alterations to the order of priority of payment of government dues. The Code also has an overriding effect over all other legislation in India and this is the first of its kind in India.

The RBI has published a circular titled "Master Directions on Issuance and Operations of Prepaid Payment Instruments (PPI) in India". PPIs are payment instruments that facilitate the purchase of

goods and services including financial services. They work in the form of smart cards, magnetic stripe cards, internet wallets, mobile wallets and any instrument that can be used to access the PPI and to use the amount therein. The government of India should exploit this opportunity and consider this as an opening for the entry of Islamic banking into India. There are various jurisdictions which use Shariah compliant prepaid instruments to cater to the needs of the Muslim communities and a similar approach can be adopted by the Indian government.

Conclusion

According to experts, Muslims have been the least financially savvy segment of India's population. As per the Sachar Report 2006, Muslims account for only 7.4% of total bank deposits and 4.7% of total loans disbursed by banks even though they account for 13.4% of the population. These numbers have not changed significantly over the years and have seen a minimal increase.

Furthermore, due to a scarcity of options available to the Muslim population to invest in, they have resorted to non-mainstream channels of investment which are not transparent. One example is where Muslims are investing with a company that claims to deal in gold and promises to double investments in two years. There is no tax deduction at source, no dividend distribution nor are the shares of the company listed; there is no way to keep track of the operations of the company but investments in the company are flourishing due to word of mouth. The government should see this as a plight of the Muslim community due to a lack of being provided for by the government and the religious constraints on investments with interest.

The major issue faced by the introduction of Islamic finance in India is the legal framework. India should aim to integrate Islamic finance within the existing banking setup, as done by Malaysia. The government should propagate the awareness of Islamic finance and maintain that the Islamic financial system is not only for a specific community.

Indonesia's Islamic finance initiatives: Impact to be seen

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Fitch believes there is ample room for growth in Indonesia's Islamic finance sector as the industry remains untapped relative to countries like Malaysia, particularly as Indonesia has the world's largest Muslim population. Government support has also been a key driver and continues to provide the foundations for growth. The Financial Services Authority (OJK) published a Shariah (Islamic law) Finance Development Roadmap for 2017-19 in June this year, and a high-profile National Committee for Shariah Finance was then formed in July to accelerate the sector's development. Their broad objectives are to increase Shariah compliant products, expand access to Shariah products and services and improve human resources, among others.

Review of 2017

Capital market products continue to be the main driver of Indonesia's Islamic finance industry. This includes Shariah stocks, Sukuk and mutual funds. Companies have issued Sukuk worth IDR4.32 trillion (US$318.66 million) between January and the 21st July this year, equivalent to the amount for the whole of 2016, OJK data shows.

The share of Islamic banking (banking or financing activity that complies with Shariah) has stabilized at 5% of total banking market assets after rapid growth in 2013. That is much lower than the regulator's 2020 target of 10%, partly because this sector is beset by weak asset quality and non-performing loans.

As for Islamic insurance, the demand for Takaful products remains low compared to regional peers, due in part to a lack of awareness and understanding of these products.

Preview of 2018

Fitch sees a case for growth of corporate Sukuk issuance in Indonesia, mainly because it is an underpenetrated universe, and Indonesia's broad and deep corporate sector of financial firms, commodity producers, property developers and other companies are seeking capital. At the same time, there has also been a push from OJK for infrastructure-related state-owned enterprises to issue Sukuk, given the country's focus on closing the infrastructure gap.

The growth potential is indeed huge, especially since the first corporate Sukuk facility in Indonesia was sold only in 2002, whereas Malaysia's first corporate issue was in 1990. At the end of June 2017, outstanding Sukuk made up only 4%, or less than US$1 billion, of Indonesia's debt capital market (Sukuk and conventional bonds). In contrast, Sukuk made up 74%, or more than US$90 billion, of Malaysia's debt capital market at the end of 2016. Indonesia may close the gap over time as investors and issuers become more familiar with the risks and rewards related to Islamic debt.

However, challenges remain. There may be little incentive for borrowers to issue Sukuk instead of conventional bonds as the funding costs are somewhat similar. The lack of legal precedents of effective enforcement is also of particular concern in Indonesia, which Fitch classifies as among countries where the law is not supportive of creditor rights or there is a significant variation in the application of laws.

As for Islamic banking, the government and OJK launched a new micro Waqf bank in November 2017. The unusual characteristic of this institution is its funding – it exclusively obtains funding from Waqf, or religious charitable donations. This will enable the micro Waqf bank to provide low-yield financing (around 3% per annum compared with typically double-digit yields across the banking industry) to its customers, although ticket size will be low, ranging between IDR1-5 million (US$73.76-368.82).

We expect new products for Islamic banking, such as a Waqf venture bank (management of endowments including property and other non-cash assets for the benefit of society), to be rolled out in the short term. These initiatives could provide a boost to the industry in 2018, which is likely to expand at a faster pace than conventional banking. Growth in Islamic financing was 7.7% year-on-year in the first eight months of 2017, compared to the conventional banking industry's 2.5% growth. However, we expect Shariah financing to remain a small portion of the overall Indonesian banking industry in the medium term.

In terms of the Takaful industry, Fitch expects Family Takaful to remain the largest contributor to the Shariah insurance market in the near term, and the segment to remain small relative to its conventional peers (Takaful accounted for around 6% of the overall insurance market in 2016). Government efforts in promoting consumer awareness will improve market penetration; and continued development of distribution channels, in particular the agencies, will enable Takaful companies to reach out to the mass market more effectively. The ability and willingness of Takaful operators to develop products that cater to lower-income segments will also be important in unlocking the industry's potential.

Takaful windows will continue to dominate the market, as the deadline for spinning off operations into separate entities is about six years away. The majority of operators, who lack the economies of scale, are likely to continue using the operational leverage offered by the window structure to expand the Islamic insurance business within a conventional setup.

Conclusion

Indonesia is already one of the world's largest issuers of international sovereign Sukuk, and government initiatives to develop Islamic finance may provide a catalyst for growth in the corporate Sukuk, Islamic banking and Takaful sectors in the country. However, a lack of product familiarity and understanding, minimal standardization and the inertia to move away from more familiar conventional banking products continue to be key challenges.

Iran's financial system – toward development of Shariah compliant instruments and institutions

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Based on Iran's constitution, all financial activities should comply with Shariah rules and regulations. For this, it is not lawful to trade any conventional financial instruments or to establish any financial institution where its performance contradicts Shariah rules and regulations. Considering the aforementioned point, the following will take a look at important developments and innovations in the Iranian financial system in 2017 and a peek into what is in store for 2018.

Review of 2017

Table 1 lists the main developments witnessed in the Iranian financial system in 2017.

Preview of 2018

In 2018, the Iranian financial system is expected to strengthen the current available mechanisms and develop the market. In this regard, in 2018 there could be some innovations and modifications. Table 2 shows a brief snapshot of what 2018 could bring.

Conclusion

2017 was a year in which the Iranian financial system stayed on its path toward development in a more conservative manner. I think it was a result of the policymakers' decision to strengthen and deepen the market. We had the development of the Islamic treasury notes market on one hand and a greater amount of sovereign Sukuk on the other. However, the Islamic mortgage-backed securities market did not expand in 2017. I think 2018 would be a more rewarding year for investors as the market policymakers are trying to introduce new instruments and the development of new financial institutions such as rating agencies.

Table 2: Iran's financial system in 2018

Islamic equity market	The SEO introduced new mechanisms for equities trading halts in 2017 and hopefully this will result in much fewer trading halts in the equities market.
Islamic derivatives market	In the Shariah compliant derivatives market, there are hopes of welcoming a portfolio futures market as an alternative to conventional index futures.
Sukuk market	In 2018, there would be more sovereign Sukuk issuance to finance the government. Usufruct Sukuk may come on the stage as a new Sukuk type in Iran.
Islamic treasury notes market	Issuing and trading Islamic treasury notes would be an important section in the market.
Islamic mortgage-backed securities	We hope to have Islamic mortgage-backed securities as a Shariah compliant mechanism for financial institutions in 2018.
Investment banks	There may not be newcomers but the development of a range of services is expected for Iranian investment banks in 2018.
Brokerage companies	The SEO is planning for more control and supervision of brokerage companies' activities which could lead to better provision of services.
Islamic funds	The development of funds and client diversity will hopefully happen in 2018. Specifically, project funds could attract more attention in 2018.
Rating agencies	As a new type of financial institution in the Iranian capital market, there is more scope for rating agencies to develop in 2018.

Source: Author's own

Table 1: Iran's financial system in 2017

Islamic financial instruments	Islamic equity market	Market cap as at the end of October 2017 reached US$120 billion. Almost 70% of the value was attributed to the Tehran Stock Exchange. Number of listed companies was 422 in two exchanges for securities: Tehran Stock Exchange and Iran Fara Bourse.
	Islamic derivatives market	Like previous years, gold coin futures contracts played a major role in the Islamic derivatives market. Currency futures contracts was a subject put on the table. Single stock futures and equity embedded options were traded as well.
	Sukuk market	Sukuk Ijarah, Musharakah, Murabahah and Salam were the four types of Sukuk issued in the Iranian capital market in 2017. The Sukuk Manfaah structure faced important discussions for issuance but was not finalized. Sovereign Sukuk were issued for state fundraising in 2017. The value of outstanding Sukuk reached around US$6.5 billion.
	Islamic treasury notes market	Following the resolution of the Shariah Board of the Securities and Exchange Organization of Iran (SEO), the government used Islamic treasury notes for fundraising where contractors who had delivered projects to the government received some notes and had the option to discount them in the capital market and obtain financing through the Islamic treasury notes. The value of outstanding Islamic treasury notes came to around US$3.3 billion as at the end of October 2017.
	Islamic mortgage-backed securities	After long negotiations, debut Islamic mortgage-backed securities were issued in 2016. Islamic mortgage-backed securities are mainly used for securitizing residential receivables from Bank Maskan in Iran. However, the Islamic mortgage-backed securities market did not grow in 2017 due to some operational restrictions.
Financial institutions	Investment banks	There are nine investment banks active in the Iranian capital market. Except for one specialized investment bank which operates in the housing sector, the other eight investment banks provide a general range of services to clients.
	Brokerage companies	As of the end of October 2017, there were 108 brokerage firms officially active in the market. However, they are licensed to provide different services depending on their capital adequacy as well as SEO permissions.
	Islamic funds	In 2017, more than 180 funds provided different services including fixed income and variable income and index trading services. The asset value of these funds exceeded US$37 billion as at the end of October 2017.
	Rating agencies	2017 was a year in which the Iranian capital market witnessed considerable improvements in finalizing the rating industry. As a new type of registered financial institution, there was one rating agency which officially received a license to operate in the Iranian capital market.

Source: Author's own

Islamic finance development at a slow pace while Italian economy recovers

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After years of stagnation, if not recession, the Italian economy is now recovering. Indeed, Italy's GDP advanced 0.4% in the three months to June 2017, unrevised from the preliminary estimate and following an increase of 0.4% in the previous period. The expansion was driven by firm consumer spending, a rebound in fixed investment and inventory accumulation and supported by external and domestic demand, but fading tailwinds and lower medium-term growth prospects were expected to moderate growth toward the end of 2017. Non-energy industrial goods and services prices are set to drive higher headline inflation, while wage pressures remain limited. The general government headline deficit is predicted to slightly decline over the forecast period while the debt-to-GDP ratio is not expected to fall below 130%.

On the production side, industry and services activity expanded, while agriculture contracted. Year-on-year, the economy grew 1.5%, the most since the second quarter of 2011.

Review of 2017

Looking back to Islamic finance-related events that occurred in the last 12 months, the most relevant one, on the legal framework side, was the law proposal brought by the chairman of the Financial Committee of the Chamber of Deputies, Maurizio Bernardo, aimed at regulating the tax treatment of certain Islamic financial operations executed in Italy, therefore realizing a level-playing field for the industry when compared to conventional finance, in particular by removing the double taxation which may affect those contractual structures, like Murabahah and Ijarah, that are based on the purchase and subsequent resale by the lender of a specific asset.

The law proposal is divided in three main parts. The first part regulates the tax treatment of three specific Islamic contracts: Murabahah, Ijarah and Istisnah. It provides that the spread paid by the client entering into these three contracts will be considered capital income and, consequently, deducted in compliance and within the limit of the Italian Income Tax Code, but it is also exempt from value-added tax (VAT). Furthermore, as like medium to long-term conventional financing, parties entering into the aforementioned Islamic contracts could also take advantage of paying a lower substituting tax, instead of stamp and cadastral duty and other administration taxes.

With reference to the second part, the law proposal aims at introducing Sukuk in the Italian jurisdiction by regulating the public offering of such securities. From a tax perspective, if not differently provided, transactions where an originator transfers to an SPV assets which are then leased back by the latter to such originator so that the SPV may issue for the benefit of the investors certificates in the form of Sukuk, are treated as a single financing transaction and subject to the same rules and tax treatment of receivables securitization transactions, and therefore, for instance, not subject to VAT.

Finally, the third part is entirely dedicated to the anti-money laundering and anti-terrorism provisions in compliance with the European Anti-Money Laundering and Countering the Financing of Terrorism legislation.

The second most relevant 2017 event was the structuring and certification respectively by Italian law firm NCTM and Shariah Review Bureau (SRB), an international company leader in the field of Islamic finance consulting, of the first Italian Islamic bond. Both firms teamed up to work on instruments provided by the Italian legal framework in order to structure a debt instrument with a participating return compliant with Shariah principles. Such a result, and the related certification, has been achieved by using a scheme that links an association in a participation agreement with a zero coupon bond.

Preview of 2018

Looking ahead to the upcoming year, it is unlikely, unfortunately, that the aforementioned law proposal will be passed in the near future. In fact, at the beginning of 2018 general elections will be held and until then, the present parliament will deal only with the most relevant draft bills, in particular the 2018 budget law. It is difficult to foresee now how the new elected Italian parliament will approach Islamic finance and the law proposal in particular.

It is instead hoped that the new Italian Islamic bond may soon find its market, helping Italian SMEs in accessing the Islamic finance debt capital markets.

Conclusion

Looking at the initiatives carried out by other European countries, including the announcement in early September of a new UK sovereign Sukuk issuance, it is clear that Islamic finance is not developing in Italy at the same pace. It remains to be seen whether and how the legislative and ruling bodies that will be elected and appointed in 2018 will take a view on this alternative ethical way of financing. What is clear, in fact, is that if they will not consider it a viable tool to accelerate the growth of the Italian economy. In this country, it will most likely remain only a matter of interest to those who have a passion for it.

Ireland: A potential destination for investors looking beyond London and the UK

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The uncertainty created by the Brexit vote in 2016 has continued throughout 2017 with Brexit dominating many discussions but transaction activity has continued unabated. In Ireland the financial services and insurance industries have been net beneficiaries of the uncertainty with many household names announcing moves to Ireland and other centers across Europe. It is still unclear what form Brexit will take and the only thing that is clear is that no one knows what the outcome and its consequences will be.

Broadly speaking, the Irish economy has surged ahead in terms of economic performance and the property market (both residential and commercial properties) has seen strong growth fueled by a shortage of supply relative to demand. Credit remains constrained but as new entrants join the market and competition between existing institutions for market share increases, the interest rate environment has begun to normalize by reference to European neighbors.

Review of 2017

In 2016, we predicted an increase in relocation activity as a consequence of Brexit in both the financial services and legal sectors and this has proven to be the case in both sectors. However, we are also observing increased activity by corporates concerned about their EU business in preparation for Brexit. They are ensuring their distribution, manufacturing and intellectual property structures are compatible with whatever shape Brexit takes (any customs arrangements which might apply and before any duties or taxes might be introduced on the movement of such assets, rights or agreements across the EU). Significant events in 2017 included the following:

- The announcements by Barclays Bank, JPMorgan, Beazley, Legal & General, Chaucer, Bank of China, Citi and Credit Suisse regarding increases to or the establishment of operations in Ireland and the opening by Pinsent Masons and Simmons of Dublin offices.
- In terms of Sukuk, among others, the listing in April 2017 of the world's largest Sukuk on the Irish Stock Exchange by the Kingdom of Saudi Arabia totaling US$9 billion.
- In real estate terms, 450,000 square feet of office space was acquired by JPMorgan, AIB and Facebook in the second quarter of 2017.

The Central Bank of Ireland increased its staff numbers in response to the level of interest by financial institutions and the fintech sector as a consequence of Brexit and has provided clarity in relation to its authorization process and the application procedure for applicants.

To date, it does not appear that UK-authorized Islamic financial institutions have considered that the loss of passporting rights (access to EU member states) is a key part of their operations as there has not been any significant announcements in terms of strategy.

The discussions to date have been rather inward, focused on how Brexit might affect the UK (in particular London) property market and the carrying-on of business generally in the UK. Perhaps this has been because limited use has been made by Islamic institutions in the UK of passporting entitlements. However, with the increasing focus on fintech and the opportunities for Islamic finance, this may change.

Ummah Finance and Yielders were standout launches in the UK for Islamic finance but the question remains how these companies might make an impact in Europe outside of the UK without access to passporting entitlements.

In terms of the property market, according to JLL, overall investment in the Irish commercial property market exceeded EUR1.3 billion (US$1.53 billion) with the total volume for 2017 likely to reach EUR2-2.5 billion (US$2.36-2.95 billion). While substantially down from 2016's high of EUR4.5 billion (US$5.3 billion), vacancy rates in the Dublin office market are still running at 7.4%, only just over 4% in the Dublin 2/4 Grade A office market, with 4.1 million square feet of office accommodation under construction and the total takeup for 2017 expected to exceed three million square feet.

Proposals have been brought forward, as part of the government's strategy, for significant changes to planning and development laws to allow construction of high-rise developments with shared services in the city center. The proposals aim to develop the build-to-rent sector with a review of the limits on urban heights to permit more high-rise development.

Preview of 2018

The prospect of a customs border with Northern Ireland remains a concern for the Republic of Ireland and Northern Ireland, as do concerns for the agriculture and export markets. However, sectors such as financial services continue to flourish and decisions on the relocation of the European Medicines Agency and European Banking Authority from London are awaited from the European Commission at the time of writing. Dublin is one of the key candidates in the mix for these prestigious institutions. Further relocation activity and announcements will continue into 2018 as the terms of the Brexit negotiations are ironed out between London and EU member states.

Opportunities abound for Islamic finance in Ireland. Commercial property is enjoying a resurgence with internationally renowned tenants and landmark properties available for acquisition, a range of PPP projects underway and interesting prospects for social housing projects and equity investment in the property sector. All of the above accompanied by a renewed interest in Islamic finance will hopefully yield progress for the sector in Ireland in 2018.

Ireland as a location in Europe bears the most striking similarities to the UK and remains a key alternative jurisdiction in the EU for companies and institutions to maintain their EU presence. Its strengths include being an English-speaking, common law jurisdiction, with an established and familiar legislative framework in terms of company legislation, a system of property registration and property rights. It has long established a legislation framework which facilitates equal taxation treatment for certain Shariah compliant structures and a highly developed financial industry with a skilled professional workforce and extensive fintech and technology infrastructure.

Conclusion

Ireland has been on the verge of establishing itself as a key jurisdiction for Islamic finance in the EU for a number of years and perhaps Brexit will provide the necessary impetus for institutions and Middle Eastern investors to look beyond London and the UK. We are currently working on a number of interesting projects which may contribute to the advancement of Islamic finance in Ireland.

Cote d'Ivoire remains vital region for the development of Islamic finance in West Africa

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As the leading exporter of cocoa and among the largest exporters of coffee and cashew, Cote d'Ivoire is by far the most efficient economy and the best gateway to business in West African Economic and Monetary Union (WAEMU) countries. Resolutely focused on the future since its exit from the sociopolitical crisis in April 2011, Cote d'Ivoire has adopted, from 2011 to 2015, a national development plan aimed at upgrading and modernizing the country. In 2015, the country made a strong entry into Islamic finance with the issuance of its first Sukuk worth XOF150 billion (US$271.94 million).

2015 was a year of steady growth for Islamic finance in Cote d'Ivoire which has since set the stage for the country to position itself as the hub of Islamic finance in the region. This is demonstrated by the country's appeal to 500 high-level experts, personalities and other decision-makers who chose Abidjan to host 1st Islamic Finance Africa Forum in the region to discuss the challenges and opportunities of Islamic finance for African economies.

The second national development plan for 2016 to 2020 has the clear ambition of transforming Cote d'Ivoire into a strong and prosperous economy by 2020. These efforts have so far paid off, with Cote d'Ivoire's economic growth ranked among the most robust on the continent. Having completed its second Sukuk issuance beyond forecasts with subscriptions of XOF158 billion (US$286.44 million) instead of the XOF150 billion announced, the country succeeded in 2016 in conducting the first listing of Islamic bonds on the West African Regional Stock Exchange.

Review of 2017

Many initiatives were taken to promote Islamic finance, including:

- The strengthening of the legal and institutional framework by the central bank (BCEAO) and also by the states, and
- The opening of Islamic windows by institutions such as the West African Development Bank and the African Development Bank.

However, since the tremendous progress recorded, Islamic finance progression has been taking longer than expected. The potentialities are enormous, so what can be the cause of this slowdown? The legal framework is certainly there but it should be strengthened.

Indeed, even if there is enthusiasm for Islamic finance at the regional level, the weakness of the regulatory framework is not likely to reassure investors who are reluctant to invest because of the various aspects that remain unclarified. Whether fiscal or financial, some mechanisms remain unclear.

In fact, when it comes to Sukuk issuance, it is relatively easy, since it is the government that raises funds and realizes the investment projects. But when it comes to private investors, it's much more complicated.

The regulatory framework issue must therefore be sorted as a priority and the project must be a matter of agreement from all states.

Things are slowly getting organized and we can only hope to see rapid progress by 2018; the Ivorian economy is facing considerable investment needs to ensure its development, especially the private sector and SMEs and also in the field of infrastructure. Islamic finance is emerging as a new funding channel, capturing some of the investment flows from the Gulf and Middle Eastern oil economies.

Islamic financial institutions and decision-makers share the responsibility for the role to be assigned to the private sector to ensure sustainability of growth and thereby enabling it to be a vehicle for wealth redistribution, stable job creation and social inclusion.

Preview of 2018

Important development opportunities, especially in real estate and funding agricultural projects and other sectors with high added value, exist. Initiatives to remove existing obstacles to enable the implementation of these projects are envisaged, including:

- Strengthening the fiscal framework in the WAEMU zone to ensure the neutrality of operations financed by Islamic finance instruments.
- Introducing Islamic finance in initial training to facilitate its comprehension and use by industry players and their customers, and
- Most importantly, completing the due diligence on Sukuk issuance by the private sector to strengthen their financial capacity to expand their productive base.

The strong involvement of the government in promoting Islamic finance will undoubtedly contribute to the effective implementation of all major projects and lead to Islamic finance expansion.

Conclusion

Despite the challenges that have hindered its development, Cote d'Ivoire has great potential to become the hub of Islamic finance in West Africa and remains a focus of interest with its large Muslim population and exceptional natural resources. The momentum should therefore be accelerated with the support of supranational organizations in the development of legislative and regulatory frameworks and encouraging the emergence of Islamic institutions, innovation and Sukuk issuance to stimulate the public sector.

Cote d'Ivoire remains a vital region for the development of Islamic finance in West Africa, playing a major role in promoting and substantially increasing the volume of Islamic financial transactions in West African countries.

We should remain attentive because great things are to come in the future...

Can Japan survive? A turning-point in the practice of Islamic finance

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Only a small frequency of occurrence of Islamic finance-related affairs in Japan. This was the case since Islamic finance was in its incipient stage in this Muslim-minority country in 2006-08. Many developments were seen during the last decade, but not frequently.

Review of 2017

There has been several Islamic finance deals by Japanese banks, not in the island country but in other parts of the world including Malaysia. One major deal was a financing to the Islamic Corporation for the Development of the Private Sector, a member of the IDB Group, by Mizuho.

An interesting example of deals that would produce Islamic finance transactions in the near future is the Softbank Vision Fund established in May this year. This is to invest in the information technology sector, and as well as technology companies such as Apple, Qualcom and Sharp, Saudi Arabia's Public Investment Fund also joined the fund. Although the fund itself is not Islamic, there may be a Shariah compliant investment or subfund.

As in the conventional finance world, fintech is gaining huge popularity in Japan. The essence of fintech is not just pursuing efficiency, but seeking additional values gained by an efficient financial transaction. In this regard, Islamic fintech has the potential of leading its conventional counterpart, and it may come from Japanese ventures in the context of social finance.

> Japanese banks' involvement in Shariah compliant finance will continue to grow. However, given the decreasing trend in Japan, they must seek overseas markets to maintain their business

There were some developments in the area of credit rating. Japan Credit Rating Agency entered into a cooperation agreement with Malaysian Rating Corporation this year, following the example of a similar agreement between Rating and Investment Information and RAM Rating Services.

There is no track record of Japanese Sukuk (J-Sukuk) so far, unfortunately. There is a framework under the existing legal system to accommodate Sukuk transactions. While legal and systematic preparations were completed in 2012, there were no deals reached although there had been some in the pipeline.

Although actual transactions are not active as anticipated last year, there is still demand from people to learn Islamic finance. A Japanese book on the globalization of Islamic finance published in February this year was intended to academically analyze the development of Islamic finance as a global phenomenon, and it is selling fairly well even for the business community.

Preview of 2018

Do not expect a huge surge in the development of Islamic finance in 2018. Rather, 2018 will be the year of a turning point in the practice of Islamic finance in Japan.

One big reason is in relation to the J-Sukuk framework. It contains a sunset clause in tax neutrality measures ending at the end of March 2019. If there is no deal in 2018, a further extension may be unlikely, which means the end of the framework itself. I do hope that there will be a Sukuk issuer. Both Japanese and non-Japanese issuers are welcomed.

Japanese banks' involvement in Shariah compliant finance will continue to grow. However, given the decreasing trend in Japan, they must seek overseas markets to maintain their business. The government is positive toward promoting the export of infrastructure packages. The target countries of course include Muslim-majority ones, which means the possibility of involving Shariah compliant finance.

Conclusion

Again, 2018 may be a turning point for Islamic finance in Japan if it starts declining. The loss of the J-Sukuk framework may mean the loss of connection of capital markets with other countries. As described previously, non-Japanese entities can also be an issuer, so readers may want to consider the possibility.

Central banks in advanced economies have started to tighten their monetary policy, except Japan, which means the interest rate will remain low in the country. In other words, the Japanese yen is one of the better currencies in which international entities may issue Sukuk. Let's see what happens.

Sharp revival of the Islamic finance industry in the Republic of Kazakhstan

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The Republic of Kazakhstan was the first country in the Commonwealth of Independent States (CIS) to adopt changes in legislation to facilitate Islamic finance and since 2009, has remained the leader in Islamic finance development in the region. This is confirmed by the rapid revival of the market in 2017 compared with previous years and the revival was made possible due to the initiatives and active participation of the National Bank of Kazakhstan, national and quasi-governmental organizations, local Islamic financial market players and public organizations.

Review of 2017

2017 began significantly with the IFN CIS Forum where global players and regulators of the Islamic finance market gathered, including CIS countries. The Astana International Financial Center (AIFC) also held an official presentation of the full publication of AAOIFI Shariah standards in the Russian language. In September, the 7th Global Fund Awards in the field of Islamic finance was held in Astana, during which the president of Djibouti, Ismail Omar Gelle, received the Global Leader in Islamic Finance award from Nursultan Nazarbayev, the president of Kazakhstan.

The Bureau of Continuing Professional Development of the AIFC together with the IDB organized a Sukuk workshop in Astana from the 18th-22nd September during the 'Islamic Finance Week', focusing on instructions on issuing Sukuk. On the initiative of the National Bank of Kazakhstan, the Association for Development of Islamic Finance was invited to the Majlis of the Republic of Kazakhstan, a government arm, where issues regarding the need to popularize Islamic finance among the population were discussed. Meetings were also held with delegations from the Asian Development Bank and the IDB on further cooperation in Islamic finance and the training of personnel.

International organizations have expressed their readiness to participate in the development of the Islamic finance market, taking into account the emergence of the new Islamic Bank Zaman-Bank, which in August 2017 successfully completed the conversion process and obtained an Islamic banking license from the National Bank of Kazakhstan. In accordance with its strategy, Islamic Bank Zaman-Bank intends to offer the market unique Islamic retail products.

After seven years of doing successful business in Kazakhstan with corporate clients, Al Hilal Bank has decided to enter the retail segment of the market to make Islamic finance products available to individuals. In August, the opening of the first Almaty branch of Islamic Bank Al Hilal was held both for corporate and retail customers.

SK Leasing, one of the oldest leasing companies, also completed the conversion procedure and became Islamic leasing company Al Saqr Finance. Al Saqr, in partnership with Bank of Astana, created the first Shariah compliant payment cards in Kazakhstan.

The emergence of new Islamic products and services was supported by Fatwas issued by the Kazakhstan Official Authority of Islamic Affairs on leasing and funds distributed to charity accrued from usury transactions. Also in 2017, over 200 employees of the financial sector were trained under the Certified Professional in Islamic Finance international program at the Kazakhstan Center for Islamic Finance and demand for such programs is growing steadily.

> "Islamic finance products remain niche and require the interaction of the regulator, other government bodies, shareholders and public organizations to be promoted to the masses"

Preview of 2018

So far, Islamic finance products remain niche and require the interaction of the regulator, other government bodies, shareholders and public organizations to be promoted to the masses. It is hoped that the Islamic finance industry in Kazakhstan will continue its development in 2018-20, taking into account the fact that Islamic deposits accessible to the population have appeared on the market.

Islamic financing products including auto financing and mortgages are also expected to appear soon. The government's DAMU Entrepreneurship Development Fund, which was successfully implemented and is dedicated to Islamic banks, is expected to continue financing SMEs in 2018.

Conclusion

Today, the Islamic finance market in Kazakhstan consists of two Islamic banks, Al Hilal and Zaman-Bank, and two leasing companies, Al Saqr Finance and Kazakhstan Ijara Company. Taking into account the continuing development of the AIFC and the activities that occurred in 2017, further development of the Islamic finance industry is expected with the entry of new local and foreign players.

Kenya's emerging landscape of Islamic finance

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Kenya is the latest African country to hop onto the bandwagon of countries wishing to issue Sukuk and create a regional hub for Islamic financial services. With this in mind, an Islamic Finance Project Management Office (PMO) has been set up in December 2015which encompasses the Capital Markets Authority and other financial services regulators. The PMO is overseen by the National Treasury with technical and financial assistance from Financial Sector Deepening Africa and under the mandate delegated to it by Kenya's Financial Sector Regulators Forum.

The PMO is led by Islamic Finance Advisory and Assurance Services, an international consultancy firm specializing in Islamic finance, in collaboration with international law firm Simmons & Simmons. This development is due to Kenya's thrust to become an international financial services hub by setting up the Nairobi International Financial Center.

Furthermore, Nairobi Securities Exchange and NASDAQ Dubai have signed an MoU to collaborate in establishing a Sukuk market in Kenya. Through the MoU, both parties will work together to assist Kenyan entities including the government, private businesses and government-related firms in issuing and listing Sukuk. According to a joint statement, the two exchanges will also jointly promote Islamic capital market products and exchange information and experiences.

Review of 2017

The Capital Markets Authority (CMA) of Kenya has been admitted by the Council of the IFSB as an associate member of the board. This will give the capital markets regulator the capacity and capability to regulate the growing Islamic finance market, which has great potential due to a significant Muslim population in certain areas of the country.

Currently, Kenya has three fully-fledged Islamic banks – First Community Bank (FCB), Gulf African Bank and DIB Kenya, a subsidiary of Dubai Islamic Bank – plus five conventional banks offering Islamic windows; one full insurance company (Takaful of Africa); two credit unions/savings and credit cooperatives; one Takaful company; one re-Takaful window; one capital market unit trust fund as of June 2017 and one non-deposit taking micro-finance institution (Hazina Development Trust). All of these are still very small compared to the potential.

In terms of the broader Islamic financial services market, the Central Bank of Kenya has to date licensed two Islamic banks: Gulf African Bank and FCB, while various other banks are offering Shariah compliant services and products through Islamic windows. Similarly, FCB has been authorized to act as an Islamic insurance (Takaful) broker for General Takaful products. In addition, Takaful Insurance of Africa, the first fully Shariah compliant insurance company in Kenya, was launched in January 2011. In 2014, the launch of the first re-Takaful insurance (Islamic reinsurance) is expected as Kenya Reinsurance Corporation ventures into Shariah compliant business. The local reinsurer already has a presence in West Africa and Middle East markets and hence has the potential to provide a regional platform for this product.

Amendments to Finance Act No 15 of 2017

The Finance Act No 15 of 2017 paves the way for the taxation and regulatory harmonization of Islamic finance with conventional finance by leveling the playing field that is expected to spur the issuance of sovereign Sukuk by the government of Kenya, the pricing of which is important as it will be the benchmark (risk-free) cost of finance for the issuance of Sukuk by county governments and corporates. This involved amendments to the Income Tax Act, Value-Added Tax Act, Public Financial Management Act (paving the way for the issuance of sovereign and sub-sovereign Sukuk) and Stamp Duty Act.

Preview of 2018

With a vision themed 'The heart of African capital markets', the Capital Markets Master Plan envisions that the Kenyan capital markets will become sufficiently deep and dynamic to stimulate domestic development, while simultaneously providing a gateway to Middle Africa for regional and international capital flows. By 2023, it is expected that Kenya will have been transformed into the choice market for domestic, regional and international issuers and investors looking to invest and realize their investments in Kenya, within East Africa and across Middle Africa. The market will be the center of excellence for the real sectors of the economy in which Kenya already has significant capacity and potential, including agriculture, infrastructure (including real estate) and technology, while also leveraging the strength of Kenya's financial sector to develop innovative products and services, including derivatives, asset management and Islamic finance.

In the capital markets, the CMA has also licensed FCB Capital, which offers Islamic asset management services. In addition, Genghis Capital has been approved to operate an Islamic collective investment scheme. The CMA has also introduced new regulations relating to REITs and these regulations provide for the creation of Shariah compliant REITs. These developments have enabled the formerly unbanked Kenyans and specifically the Muslim communities in the country to have access to financial services, adding to wealth creation in the economy.

However, to develop a center of excellence in Islamic financial products underpinned by a formal framework, a concerted program of regulatory reform and recognition as well as broader capacity-building will have to be undertaken so that Islamic financial services become a sector in their own right capable of attracting international business. To achieve this outcome, the following actions should be taken:

- Create a regulatory framework for Islamic capital markets
- Develop a separate policy, legislative and regulatory framework for Islamic products and services
- Leverage existing relationships to develop Islamic finance expertise, and
- Identify and make policy proposals to facilitate the development of Islamic finance in the annual Memorandum of Policy proposals to the National Treasury and implement programs through industry coordination and relevant partnerships.

Conclusion

These changes have significantly changed the landscape of Islamic financial services in Kenya and it is our hope that the Kenyan public will benefit from them and they are implemented well by professional service providers.

A short-term perspective on the status quo of Islamic banking in Lebanon

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Operations in Lebanon in recent years have not been very pleasant financially for Islamic banks with regards to asset-building and generating satisfactory profits. Currently, the four Islamic banks offering Islamic banking services through 14 branches countrywide will continue without any envisaged new entries into the Islamic banking sector from local or foreign banks in the foreseeable future due to current market constraints.

Review of 2017

Since taking effect, the Islamic banking regulations that were approved in 2004 have placed Islamic banks at a disadvantage due to, among other reasons, the legal status regarding foreign ownership and value-added tax (VAT) rules.

Deposits in the banking sector, which continue to increase at an average rate of 4.5% annually, have reached a level of US$175 billion by the end of 2016 and US$192 billion by mid-2017, while assets reached US$217 billion by the end of 2016. The share of Islamic banks did not exceed 0.3% of assets with a volume of US$700 million and 0.2% of deposits with a volume of US$300 million.

At the same time, an analysis of the balance sheets of the four Islamic banks revealed that assets were restrictively concentrated on Murabahah financing due to the aforementioned legal and tax restrictions which resulted in losses for a couple of banks and meager profits for the other two.

Preview of 2018

The future expansion of Islamic banking operations requires joint efforts to address several issues with governmental and regulatory bodies (in parentheses) such as the following:

1. The waiver of the VAT for Murabahah transactions (Ministry of Finance)
2. The waiver of real estate transfer of ownership registration fees for lease-to-own transactions (Ministry of Finance)
3. The relaxation of the restriction on foreign ownership (political parties within the parliament), and
4. To have Shariah compliant financial regulations and subsidy modes to expand business operations and utilize available liquidity and reserves in various investment transactions (Central Bank of Lebanon).

The aforementioned topics must be discussed with conviction and regulatory authorities must be eager to provide possible Shariah compliant modes that reflect positively on the status of Islamic banks, given the current legal and political constraints. This requires a high degree of cooperation from Islamic banks to apply gradual enhancement efforts, not forgetting the importance of an awareness campaign on Islamic banking addressed to the general public.

The Central Bank of Lebanon has already expressed its support for Islamic banks to lobby and conduct open discussions with relevant official authorities in an effort to explain the benefits of amending the current legal and tax status of Islamic banking transactions, and to elaborate on the relevant positive effects of meeting corporate and retail financing needs and the effect on the performance of the banking sector in general.

On the other hand, the central bank is aware of the prevailing unfavorable environment for Islamic banks with respect to reserve funds and subsidized interest for financing programs which are not compatible with Islamic banks. Providing equal opportunities for Islamic banks requires negotiations and discussions between Islamic banks and the central bank to arrive at the best convenient Shariah compliant structure to generate income from reserve funds and participate via market share in subsidized financing programs.

Another option for foreign Islamic banks may be to increase their capital structure by issuing an IPO for the Lebanese public and investors with a 51% ownership share. The benefits of such an IPO include fortifying capital formation, providing additional liquidity for financing, shifting from foreign entities to Lebanese entitiesy, avoiding the foreign ownership obstacle and activating the local financial market.

An alternative for Lebanese Islamic banks may be to finance projects for the reconstruction of Syria, the volume of which is estimated at an excess of US$1 trillion. Two basic options can be utilized: provide financing within the limits of foreign transactions set at 50% by the Lebanese central bank, or establish new banks in Syria licensed by the Central Bank of Syria, and thus constitute new members in the Islamic banking sector in Syria.

Conclusion

Until now, Islamic banks in Lebanon have not applied the syndicated lobbying approach with official authorities and are still only confined to discussions with the central bank as a regulatory authority. The Lebanese banking sector provides a sizeable opportunity for Islamic banks with the current deposit base as compared to domestic economic activity. In the absence of new requests from Islamic banks to obtain licenses to operate in Lebanon, the current Islamic banks already operating in the country have a real opportunity to benefit from the deposit base if joint efforts are exerted collectively to amend the current prevailing laws as recommended by the central bank.

Until the aforementioned issues are negotiated and solved, Islamic banking in Lebanon will maintain its status quo with a low profile until further regulatory enhancements.

Kuwait: 2018 a year to watch the Sukuk market

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This is the time of the year when both investors and practitioners pause to reflect on the year's harvest and plan for the coming year. This article will focus on the Islamic debt capital market in the GCC, where many people see potential growth and volatility at the same time, highlighting the opportunities and potential risks in one of the fastest-growing Islamic debt capital markets in the world.

Review of 2017

Despite a marginal reduction in global Sukuk issuance, sovereign issues continue to dominate the market. Malaysia maintained its lead with 38.5% of total issuances followed by Indonesia (24.7%), Qatar (9.9%) and the UAE (9%). Outstanding global Sukuk stood at US$65 billion as at the end of September 2017, with Malaysia maintaining its lead by commanding 48% of the total amount. Dana Gas's Sukuk default was the highlight event of the year which shook the market deeply.

Preview of 2018

Looking at the year ahead in the context of the economic and geopolitical climate, oil prices are likely to stay around the US$50 per barrel level given the current slowdown in China, the slow recovery in Europe and the increased interest in alternative energy sources and technology, making oil more of a commodity. This, coupled with the budgets of most GCC countries (except Kuwait) averaging a breakeven point north of the US$50 oil mark, would result in budget deficits. Structural changes (reduction of subsidies, cost cuts, taxes and such) are bound to happen but until then, the GCC governments will be looking closely at raising debt both locally and internationally. While issuance levels may taper off over the next 18 months, GCC governments nonetheless require some US$275 billion over the next two years to meet their financing needs; half of it, S&P believes, will be raised via the debt capital markets through a combination of bonds and Sukuk.

So far, investors' appetite has been favorable and sovereign bond issues have been oversubscribed due mainly to relatively lower leverage rations and regional pricing premiums for comparable credit ratings (compare Kuwait's pricing with that of South Korea).

Bahrain and Oman continued a credit downgrade as a result of their increased level of debt and diminishing income drivers might prove to be challenging for both countries to issue new papers without seeking the help and support from other GCC countries (which are currently split up and need to deal with their own budget deficits). Qatar is unlikely to tap the market with new issues but rather will refinance existing maturities. The UAE and Kuwait will continue to grasp investors' attention given the size of their sovereign wealth funds and oil reserves.

Finally, Saudi Arabia will be an interesting case to watch as the country's ambitious Vision 2030, its political, social and financial challenges plus its support of coalition allies to remain intact will put a lot of pressure on Saudi Arabia to embrace a tight and delicate borrowing strategy in terms of the mix of instruments: local and international, currencies and markets. Saudi's budget deficit dropped from US$75 billion in 2016 to US$53 billion this year through a series of cost-cutting and increased revenue from non-oil sectors. But that will not be enough and the country is expected to have around US$200 billion in debt by 2020, at which point the market risk will be looked at more closely by investors and pricing is likely to go higher.

In general, increased borrowings are likely to see issuers opting to borrow in major Asian currencies and the euro to tap into new sources of funding, which means we could see dim sum issues. A word of caution: at least one country could face financial distress unless it receives financial aid from neighboring countries or international aid.

The other main trend for 2018 is expected to be a continuation of consolidation between banks. The merger between Kuwait Finance House and Ahli United Bank Group is expected to go ahead to create the largest bank in Kuwait and the sixth-largest in the GCC. Qatari banks' results are likely to suffer as a result of the embargo and drop in business levels but will remain intact due to government support.

Competition to financial institutions is likely to come from outside their market with fintech companies gradually capturing market share due to their flexibility as opposed to more rigid structures. Regulators are looking to closely regulate such services which would mean a barrier to entry.

Conclusion

The same story continues with sovereign issuers dominating the market with Malaysia still number one in terms of Sukuk issues; however, with the level of required debt in the GCC. this is likely to change in 2018. The US dollar overtook the Malaysian ringgit in terms of Sukuk issuance. As a currency, the US dollar is still the most preferred denomination for Sukuk. By tenor, market preference shifted toward long-term Sukuk because of lower supply. With issuers from new frontiers in Asia and North America, all in all, I foresee Sukuk issuances to easily surpass US$80 billion in 2018.

Ethical finance in Luxembourg


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The Grand Duchy of Luxembourg is already experiencing an increasing demand for ethical finance services and a growing need for alternative and sustainable finance. This is driven by the new perception of the public after the effects of the last financial crisis. Such interests offer new opportunities for the market especially around ethical finance which encompasses two main areas: sustainable finance that includes environmental, social and governance (ESG) awareness, and Islamic/faith-based finance.

Islamic finance and social responsible investment share a lot of commonalities such as fairness, equality, ethical beliefs, profit-sharing principles and sector-based exclusions (with the exception of interest-based activities that may not be included under sustainable finance).

> "Whether sustainable finance and Islamic finance are used on their own or together, using both is proven to be effective in Luxembourg. The market currently has demand and interest for this kind of ethical finance which is on track to prove itself in the near future"

Review of 2017

The government of Luxembourg has encouraged several initiatives to support and enforce ethical finance. The country already has domiciled funds with responsible investment strategies and Islamic ones: In January 2017, 320 ethical and Islamic funds were domiciled in Luxembourg with 63 ethical and Shariah compliant management companies, according to Lipper. Additionally, according to the 2017 Luxembourg for Finance brochure: "Many Islamic fund managers have gone beyond compliance with traditional Shariah rules to add social and environmental screening to their investment process. Indeed, Islamic law encourages this. Certain Islamic asset management companies have signed up to the UN Principles for Responsible Investment."

Luxembourg has started to make itself well known in both sectors of ethical finance. Investors in either sustainable or Islamic finance may be concerned with a different set of ethical criteria and motivated by different factors for their choice to invest ethically. Particularly, in Luxembourg, ethics and social responsibility are becoming key drivers for successful financial institutions.

Preview of 2018

Indeed, with regards to sustainable finance, the government has established key focus areas to sustain green and sustainable finance. Among them is the Climate Finance Accelerator which aims to attract new and innovative fund managers and their climate-related investment vehicles to Luxembourg. The Green Bond Market is confirmed as being very active and new issuers have shown interest.

In 2007, the Luxembourg Stock Exchange listed the world's first green bond issued by the European Investment Bank. The Lux Green Exchange (LGX) has become a global market leader with a 50% market share of green bond listings during the first quarter of 2017. More than 100 green bonds are listed for a total outstanding amount of US$42 trillion. In total, listings of green bonds have increased by 25% since the launch of the LGX in September 2016. The government also launched a 'Climate Financial Label' at the Luxembourg Fund Labeling Agency in September 2016.

Regarding Islamic finance aspects, Luxembourg has a comprehensive and flexible regulatory framework, enabling the execution of Islamic finance transactions. Luxembourg is the fifth-biggest domicile for Shariah compliant funds in the world with 44 Islamic ones domiciled in 2017, according to Lipper, and 21 Sukuk listed on its stock exchange up until 2016. It must not be forgotten that the Grand Duchy was the first European country to authorize an Islamic insurance company to list a Sukuk, and its central bank was the first European central bank to join the IFSB.

Different favorable reasons make the Islamic finance perspective positive in Luxembourg. Government policies enable flexible Islamic finance services under the Luxembourg regulator, the Commission de Surveillance du Secteur Financier, where tax regulations are beneficial to Islamic banking and funds with an adapted and not onerous regulation for special investment funds. In addition, Luxembourg has strengthened its relationship and cross-border cooperation with the Middle East through the signing of an MoU with the Qatar Financial Markets Authority in 2015, and with Abu Dhabi in 2016.

Conclusion

Luxembourg has not only become a real European hub for financial players who use ESG factors but also for those who want to add Islamic screens to develop their business widely as result of a clear development between ethics and faith-based finance criteria. Whether sustainable finance and Islamic finance are used on their own or together, using both is proven to be effective in Luxembourg. The market currently has demand and interest for this kind of ethical finance which is on track to prove itself in the near future.

Sustainability of Malaysia's Sukuk market: Strong domestic demand driving resilience

Ruslena Ramli *is the head of Islamic finance at RAM Ratings. She can be contacted at ruslena@ram.com.my.*

Against the backdrop of a positive economic outlook, RAM Ratings has revised upwards its projected GDP growth for Malaysia to 5.4% from 5.2% earlier. The better-than-expected performance is underscored by the upside from trade and investment. The resilience of domestic demand remains a key driver of sustainable growth.

Review of 2017

This positive momentum underscores the healthier performance of Malaysia's Sukuk market. The local currency (LCY) Sukuk market appears set to surpass RAM Ratings's projected US$23.3-27.9 billion of Sukuk issuance in 2017, having already hit US$27.9 billion for the first nine months. Notably, Sukuk constituted a healthy 58.3% (US$173.3 billion) of total outstanding bonds in the domestic market, which added up to US$297.5 billion as at the end of September 2017. Government Islamic debt securities dominated Sukuk issuance at 36.7%, followed by corporate (35.3%) and quasi-government (28.1%) Islamic debt securities. Overall, the aggregate proportion of Islamic securities accounted for 53.3% of total market issuance.

The performance of corporate and quasi-government Sukuk remains the best yardstick in tracking the pulse of the local Sukuk market. As at the end of September 2017, financial institutions and infrastructure were the core sectors that drove the Sukuk market, accounting for a respective 49.7% and 20.7% of total corporate and quasi-government issuance.

Preview of 2018

The Malaysian government's concerted efforts to include Islamic banking and Islamic finance as policy tools in its economic agenda have been the driving force behind the country's rise in the mainstream financial markets.

The successful inclusion of Islamic finance lends considerable strength to building a sustainable Sukuk issuance pipeline, not only in meeting the government's budgetary requirements but also for quasi-government and corporate sectors.

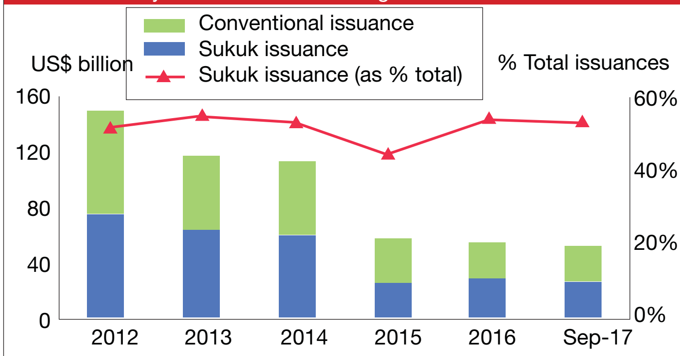
The financial institutions and infrastructure sectors will continue to underpin large Sukuk transactions due to their financing needs, which are better matched by institutional investors' appetite for long-term assets.

Conclusion

Malaysia's commendable Sukuk performance is well supported by a comprehensive market infrastructure, a robust regulatory framework and dynamic market participants. An integral component of the country's performance is the 'top-down' approach to pushing the Islamic finance agenda.

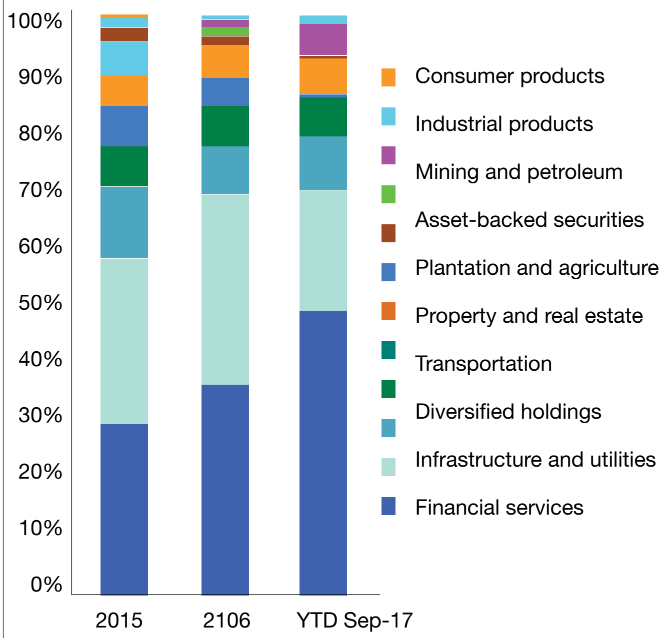
Other countries are slowly realizing that the dynamic shift toward Sukuk – instead of conventional bonds – is a balance driven by both demand (buy side) and supply (sell side). Commercial reasoning will always be the tipping point for issuers, and creating a vibrant and thriving environment for Sukuk is the key to success.

Chart 1: Malaysia's Sukuk issuance against total market issuance



Source: Bond Pricing Agency Malaysia (BPAM) and RAM Ratings

Chart 2: Malaysia's quasi-government and corporate Sukuk issuance by sector



Source: BPAM and RAM Ratings

Table 1: Top 10 issuers in Malaysian LCY Sukuk market (as at the end of September 2017)

	Amount RM billion	Amount US$ billion
1. Government of Malaysia	44.00	10.23
2. Sunway Treasury Sukuk	10.34	2.4
3. DanaInfra Nasional	7.18	1.67
4.Lembaga Pembiayaan Perumahan Sektor Awam	6.75	1.57
5. GovCo Holdings	4.2	0.98
6. Prasarana Malaysia	4	0.93
7. Perbadanan Tabung Pendidikan Tinggi Nasional	4	0.93
8. SapuraKencana TMC	3.29	0.77
9. YTL Power International	2.5	0.58
10. Pengurusan Air SPV	2.1	0.49
Top 10 issuers	**88.36**	**20.55**
Total LCY market	**119.99**	**27.9**

Source: BPAM

Islamic finance in the Maldives reaches zenith of influence with strong political will

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Islamic finance is a concept that has captured the confidence and trust of the people in the Maldives and is gaining in popularity today. The ethical and social impact it creates has proven its viability in the country, irrespective of the personal beliefs and criticisms about the operational aspect of it.

The year 2017 has demonstrated the strong political will toward the development of Islamic finance in the country and at the national level, a number of initiatives have been taken for the sustainable growth of Islamic finance. 2018 is expected to be a successful year as well for Islamic finance.

> "The success of Halal tourism in the country will set a new benchmark in the global Islamic finance and Halal sector"

Review of 2017

2017 was a successful year for Islamic finance in the Maldives. The amount received as Zakat Al Maal in 2016 was announced this year to be MVR35.8 million (US$2.29 million). On the 12th January, the first Waqf buiding in the country, Darul Eman, was officially opened by Minister of Home Affairs Azleen Ahmed. The project was started by the former minister of Islamic affairs, Dr Mohamed Shaheem Ali Saeed, with the objective of creating an investment avenue to generate income for the Cash Waqf Fund for mosques. The building is expected to generate about MVR5.2 million (US$333,217) per annum.

On the 16th January, an Islamic finance talk series titled 'Fintalk' was inaugurated by the Maldives Center for Islamic Finance (MCIF) and one of the board members, Professor Rifat Abdel Kareem, stated that the Maldives has the potential to become the hub for Islamic finance in South Asia. In February 2017, the Islamic University of Maldives (IUM) announced that it was going to build a Waqf property in Hulhumale'. On the 22nd February, the Bank of Maldives Islamic launched a financing facility for the first time for home financing. This facility can be obtained for home purchasing, home construction and home renovation purposes.

On the 23rd February, the IUM created and launched a physical and online library of Islamic finance in association with International Center for Education in Islamic Finance (INCEIF) in Malaysia. The books for the library were donated by a number of organizations such as the Islamic Research and Training Institute, the International Shari'ah Research Academy for Islamic Finance and INCEIF.

In April, the government of the Maldives purchased an additional 10% of shares in the Maldives Islamic Bank (MIB) and as a result, the government now owns a 25% stake with Amana Takaful Maldives owning 5% and ICD-IDB owning the remaining 70%. In

the same month, the MCIF launched the South Asian Institute for Islamic Finance (SAIIF) with the objective of resolving the challenge of a lack of human capital facing Islamic finance in the Maldives and the region. On the 24th April, the MIB opened a branch in Hulhumale' and during the ceremony to inaugurate it, Minister of Finance and Treasury Ahmed Munawwar announced that the government was working toward the issuance of a sovereign Sukuk facility within the year.

In August, the Housing Development Finance Corporation launched the second corporate Sukuk facility which was listed on the Maldives Stock Exchange. In the same month, the MIB launched an education financing scheme to study in local educational institutions. In September, for the first time in the history of the country, an academic conference on Islamic finance was organized by the IUM.

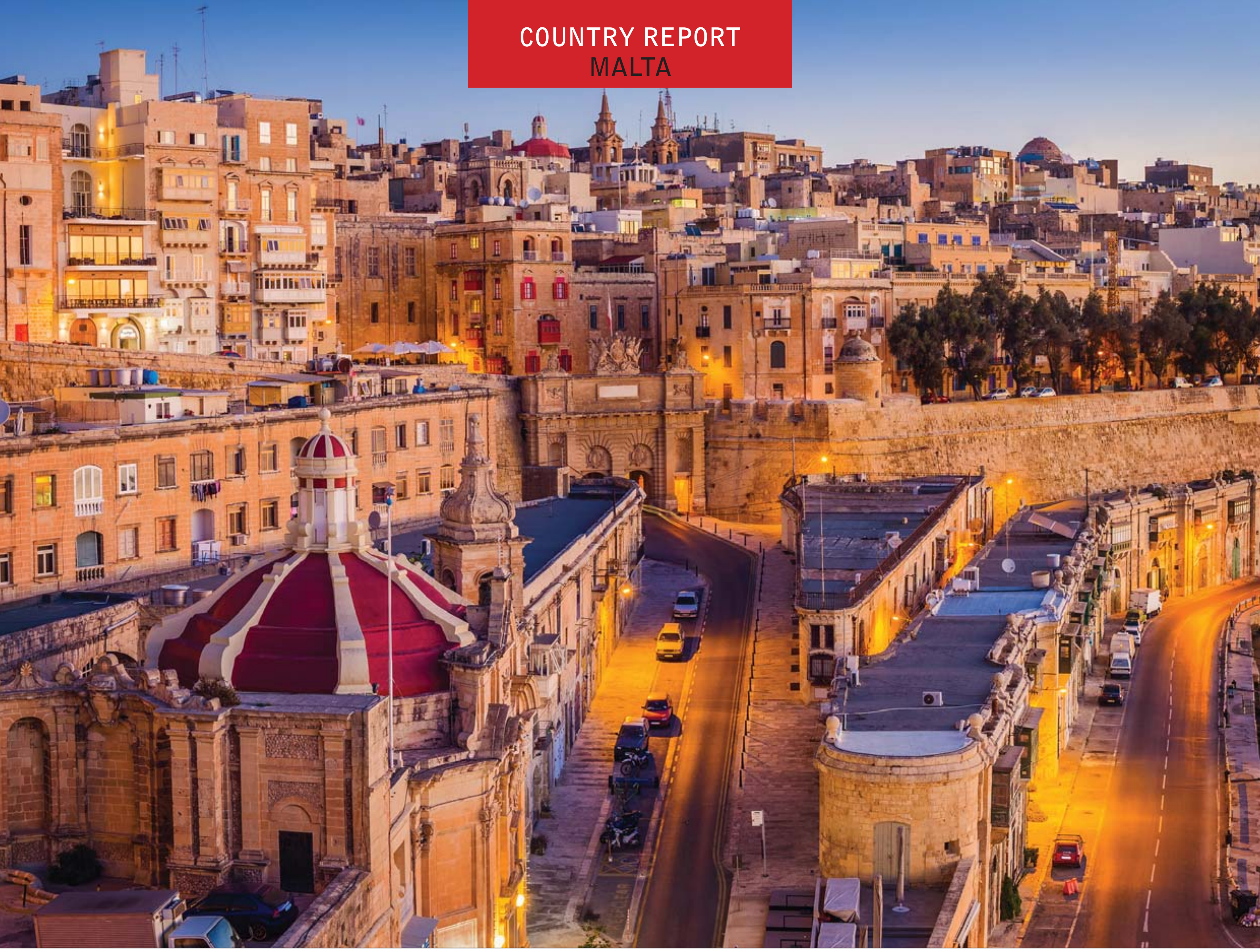
In the month of October, for the fourth time, the Maldives Islamic Banking and Finance Industry Conference was held and inaugurated by the vice-president of the Maldives, Abdualla Jihad. During the inauguration of the conference, the vice-president stressed the importance of introducing Halal tourism to the country. Currently, the MCIF is handling a project to start Islamic tourism in the country. Also in October, the Ministry of Islamic Affairs announced that MVR900 (US$57.67) per person will be distributed to the poor that are registered to receive Zakat Al Maal. This year, 16,269 people were registered as poor to receive Zakat Al Maal. There are 13 institutions offering Islamic financial services in the country.

Preview of 2018

The year 2018 will definitely be a successful year for Islamic finance in the Maldives. There is hope that the MCIF's project to create the first Shariah compliant resort in the country will be realized and innovative Islamic finance products to cater to different segments of the population will be developed. There will be a growth in Islamic finance assets and more players will enter the Islamic finance market. A sovereign Sukuk issuance will be introduced to the international market and there is hope that new Islamic capital market instruments will also be issued during the year.

Conclusion

Islamic finance is anticipated to have an evergreen future in the Maldives. The government's will to support and develop the sector is praiseworthy and this is indeed a good example for the whole of the South Asian region to develop the Islamic finance sector. The success of Halal tourism in the country will set a new benchmark in the global Islamic finance and Halal sector. Overall, it can be said that in the Maldives, with strong political will, Islamic finance has reached its zenith of influence.



Malta: Cultivating Islamic finance in the fortress island

Reuben Buttigieg *is the president of the Malta Institute of Management. He can be contacted at rmb@erremme.com.mt.*

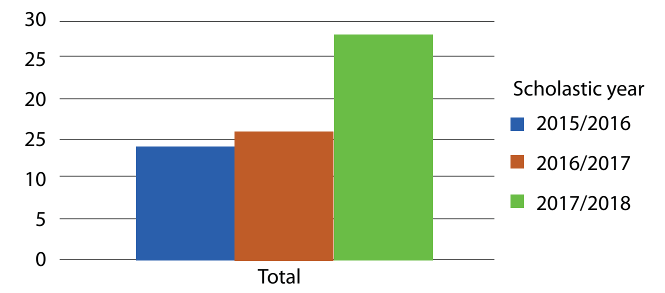
Growth is one key word that can be associated with Islamic finance. It is increasing in popularity and more and more institutions are adopting some sort of Islamic finance practices. Demand emerges from growth and this is where Malta is trying to gain recognition to satisfy some of this demand. Islamic finance, while it remains concentrated in well-established countries, is seeing activity in other jurisdictions. Malta is one of these countries trying to push the practice of Islamic finance. While Islamic finance in Malta is in its infancy, no major events happened in 2017, but still there was enough momentum to continue the progress and maintain some growth.

At the current stage, Malta is focusing more on awareness, rather than a full-blown implementation of this type of financing in the current system. The educational sector was one of the biggest successes in 2017 in creating awareness as more and more individuals are showing interest.

Review of 2017

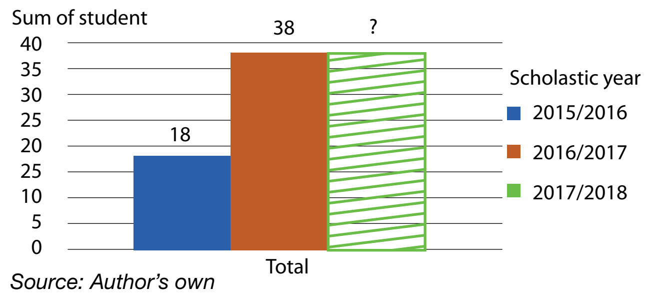
The following are some significant events related to Islamic finance that occurred in various sectors in Malta in 2017.

Chart 1: Number of students taking the Islamic finance subject at the University of Malta



Source: Author's own

Chart 2: Number of students taking the Islamic finance subject at the Malta College of Arts, Science and Technology



Source: Author's own

Education

With Islamic finance estimated to grow up to 20% annually, the need for specialized human capital in the industry is higher than ever. There is currently a shortage of staff with extensive experience in Islamic markets, and this issue needs to be addressed with the industry's rapid growth. With English as one of its official languages and building on its international reputation as a center for learning and training, Malta is well placed to host Islamic finance training institutions.

- With enough traction, interest in Islamic finance is piqued and educational institutions do indeed offer such courses to broaden the knowledge about the subject. Year on year, one can see a gradual increase in the number of students. The University of Malta offers the subject as an optional study unit. One can observe a slight increase from one academic year to another, with the number of students expected to rise in the coming years (see Chart 1).
- At the Malta College of Arts, Science and Technology, we see a higher increase, although this time around the subject of Islamic finance is indeed compulsory. This measure was taken because of the increased importance of Islamic finance (see Chart 2).
- The Malta Stock Exchange Institute offered courses which serve as an introduction to Islamic finance. Targeted individuals are those who already have experience in the workplace. This may be the most promising sector to educate the individuals' mindset as they are already work-oriented and could easily identify how they could incorporate such methods within their own business practice or to simply benefit from such methods of financing, in order to widen their perspective and incorporate this method of financing.
- A seminar was held at the Malta Stock Exchange about Islamic finance, highlighting key features such as Islamic banking, Takaful and Sukuk, aiming to provide a better understanding of how some of the services could be implemented within the Maltese jurisdiction.

Proposals

- At the end of June, Wim Services submitted an expression of interest to Projects Malta which would see the setting-up of a Bottega Museum in one of the Maltese ports called Tal-Menqa. The proposal included a Sukuk issuance which would provide Malta the financing for this project and consequently the regeneration of Tal-Menqa through foreign direct investment. Apart from this, it would open a new range of services in Malta as it would, first and foremost, ensure an alliance between the Malta Stock Exchange and the Dubai Stock Exchange for the listing of the Sukuk. This would enforce the strategy of the Malta Stock Exchange to open more services to the Islamic finance sector and boost its Shariah Index.

Chart 3: MSE Sharia Equity Index (52-week high and low in 2016-17)

Source: Malta Stock Exchange

Such a listing would put Malta on the Islamic finance world map which would result in the development of new services and opportunities for highly remunerated posts in Malta.

- At the beginning of September, a high-level proposition to finance a health center through the issuance of a sovereign Sukuk facility was put forward by Erremme Business Advisors to the health minister of Malta. The proposal was backed up with a well-defined structure of a sovereign Sukuk facility along with case studies to provide factual evidence of how other jurisdictions have implemented Sukuk to finance similar projects to the one being proposed.
- In mid-September, a consultation document was submitted by the Malta Institute of Management to the Office of the Prime Minister. The aim of the consultation document was to spur a debate on the strengthening of the Malta Financial Services Authority, which should result in improved productivity, higher efficiency and more effectiveness amid a changing regulatory landscape.

Market

- As far as the market is concerned based on one year, one can observe a 52-week low of 979.14 (7th September 2016) and a 52-week high of 1,051.93 (22nd February 2017) on the MSE Sharia Equity Index. Although there has been no drastic movement, there was a minor positive increase of 0.058% (see Chart 3).

Preview of 2018

As for 2018, further proposals are expected to be handed to the relevant authorities as early as the first quarter (Q1) and an induction of decisions with the respective ministries is foreseen by June 2018. One of the most prominent events thus far is that the Malta Stock Exchange will be organizing an International Islamic Finance Conference in Q2. Among the luminaries expected to attend the conference are Minister of Finance Edward Scicluna and Sheikh Bilal Khan. Sheikh Bilal Khan is known for his strategic leadership and management skills. He also holds various executive positions and is currently the co-chairman and partner at Dome Advisory. He was recognized as one of the eight role models for race, religion and faith at the UK's National Diversity Awards 2016 for championing diversity and inter-faith dialogue within the UK and across the globe.

Conclusion

With 2017 serving as another year of laying the foundations to Islamic finance within Malta, with proposals forwarded to the authorities as well as increasing awareness that this is an opportunity waiting just around the corner, 2018 will surely attract more attention. As already mentioned, the International Islamic Finance Conference would be one of the main highlights in 2018, as this would indeed generate interest among the Maltese as well as foreign countries with prospective clients and investors.

A challenging start for Islamic finance in Morocco

Dr Ahmed Tahiri Jouti *is COO of Al Maali Consulting Group. He can be contacted at a.tahiri@almaaligroup.com.*

It was a very challenging year in 2016 for the Islamic finance industry in Morocco in terms of legal and regulatory frameworks. With the initiation of the licensing process for Islamic banks and windows, the central bank of Morocco, Bank Al-Maghrib, received 10 license applications – seven for fully-fledged Islamic banks and three for Islamic windows.

Review of 2017

In January, the Moroccan central bank disclosed the list of licenses granted for Islamic banking activity. Eight licenses were granted, five for fully-fledged Islamic banks and three for Islamic windows, as follows:

- Umnia Bank (fully-fledged)
- Bank Assafaa (fully-fledged)
- Bank Al Yusr (fully-fledged)
- BTI Bank (fully-fledged)
- Al Akhdar Bank (fully-fledged)
- Dar Al Amane (Societe Generale Morocco) (window)
- Arreda (Crédit du Maroc) (window)
- Najmah (BMCI) – (window)

The Moroccan Shariah standards for banking approved by the Higher Council of Ulamas were published in the official journal of the Kingdom of Morocco on the 2nd March. The published standards cover:

- Five Islamic products (Musharakah, Mudarabah, Murabahah, Salam and Ijarah). The Shariah standards related to Istisnah will be drafted later due to some legal limitations, according to the central bank
- The investment accounts in terms of mobilization, investment and legal issues, and
- The regulatory requirements for Islamic windows.

In August 2017, the Murabahah contracts and the current account contracts approved by the Higher Council of Ulamas were published.

In June 2017, Umnia Bank opened three of its branches and started receiving potential customers to better understand their expectations and to present the bank's products in a pre-start phase. The top management of the bank declared that they would open other branches in the main cities of the Kingdom gradually. Umnia Bank also conducted an intense communication campaign on television, radio, newspapers, billboards, internet, social media and other communication media.

Bank Assafaa chose not to launch its Islamic banking activity until all the pending issues were addressed. The bank organized a press conference during the month of Ramadan to reveal its logo and brand and to explain to the public why the bank decided to wait before launching its products. In August 2017, Bank Assafaa launched its Islamic banking activity through 20 branches with more than 160 employees.

In September 2017, Dar Al Amane (Societe Generale Morocco) opened four branches to offer Islamic banking products.

According to the other banks, most - if not all - of the Islamic banking players will launch their activities before the end of 2017.

Most of the Islamic banks in Morocco have started to offer Murabahah financing without Takaful coverage. The regulatory framework is being discussed with different players of the insurance sector in Morocco and will be submitted to the Higher Council of Ulamas for approval once discussions are completed.

The Insurance Supervisory Authority is working on an update of the chart of accounts of the insurance sector to introduce amendments related to Takaful companies.

The Central Guarantee Fund in Morocco plays a central role in the conventional financial system. It provides several solutions to help SMEs and different segments of the population to get financing from banks. With eight new players in the field of Islamic banking, the Central Guarantee Fund aims to launch Shariah compliant solutions to serve customers who would opt for Islamic banking products. In this context, the institution is conducting a survey related to the implementation of Shariah compliant guarantee solutions. This initiative is sponsored by the IDB.

The Moroccan Clearing System conducted a study related to the conditions of adherence of Islamic banks and windows to the clearing system. Different solutions were submitted to the Higher Council of Ulamas to define the solution that responds best to the Shariah requirements of the council.

The Moroccan government has promised the Islamic banking sector tax neutrality. In this context, Islamic banks and windows have prepared a draft that was submitted to the central bank in order to introduce amendments that will ensure neutrality between an Islamic financing and a conventional loan. These amendments shall be introduced in the Finance Bill 2018.

Preview of 2018

2018 will be the year the Islamic banking sector in Morocco is expected to take off with a neutral tax framework, a comprehensive ecosystem including the Central Guarantee Fund, the clearing system and the first Takaful companies. The necessary tax amendments for Murabahah and Ijarah transactions will be introduced in the Government Bill 2018 which will encourage the industry. The first Takaful operators are expected to start their activities by the end of the first half of the year.

If all the conditions are fulfilled and if banks are developing new products to respond to customers' needs, the Islamic finance industry will achieve a very satisfying growth rate in 2018.

Conclusion

The fourth quarter of 2017 will see all players exploring the opportunities and adjusting their business models for the introduction of the Islamic finance sector in the Moroccan economic system. 2018 will be an interesting year for all the players.

Nigeria's maiden sovereign Sukuk issuance a milestone in its history

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Over the last decade, the Islamic finance industry in Nigeria has made increasingly large strides toward providing the essential services required by the country's large Muslim population. Market participants are still very few and they have had to work twice as hard as their conventional counterparts to ensure necessary regulations are established to propel the industry.

Today, the industry boasts of a mix of window and fully-fledged operators offering asset management, commercial banking and Takaful services to the high-end institutional and middle-class retail segments. The industry also serves the country's bottom of the pyramid through the existence of a few microfinance banks and cooperatives. Despite the dearth of Shariah compliant investible instruments in the domestic market, these industry operators have managed to remain competitive through astute innovation and product development. One major success factor required to further break down the barriers in the industry is greater public enlightenment and investor education.

> "The enhanced regulatory framework for the industry and the advent of a sovereign Sukuk issuance have established the industry"

Review of 2017

The year 2017 marked a turning point in Nigeria's Islamic finance industry, as it welcomed a number of breakthroughs in regulation and product breadth.

The industry's highlight started off in the banking segment when Jaiz Bank listed its shares on the Nigerian Stock Exchange in February 2017. This was a notable milestone in the bank's six-year journey as the only fully-fledged Islamic bank in Nigeria. This listing especially projected the bank's satisfactory level of governance and transparency as required by the exchange. In March, Jaiz Bank made further strides, when its subsidiary Jaiz Takaful Insurance commenced operations, highlighting its commitment to Islamic finance.

In April 2017, the regulatory milestones commenced as the National Pension Commission approved the investment of pension funds in Islamic finance assets. With total pension assets in excess of NGN6.7 trillion (US$18.67 billion), this implied that a portion of pension assets could seek out Shariah compliant instruments such as Sukuk and mutual funds. The new regulation also paved the way for pension funds to potentially drive the sale of voluntary pension schemes to investors with a bias for Shariah compliant instruments.

Toward the end of April, the Central Bank of Nigeria (CBN) released new guidelines for the regulation and supervision of non-interest microfinance banks, in a bid to deepen participation in the market. Subsequently, two new Islamic microfinance banks, Tijarah Microfinance Bank and I-Care Microfinance Bank obtained their license to operate in the northern region of the country.

In May 2017, the Debt Management Office (DMO) was finally ready to commence preparations for the country's much-anticipated sovereign Sukuk. The DMO appointed Lotus Financial Services (a non-interest capital market specialist) and FBN Merchant Bank as financial advisors, alongside legal advisors and trustees – all of which were local players. These advisors were given the role of raising NGN100 billion (US$278.69 million) through Sukuk – a task which may have proven arduous without clarity on the tax and liquidity status of Sukuk instruments.

Thankfully, in June the Federal Inland Revenue Service affirmed the Sukuk as a tax-exempt instrument, just like the conventional bond, while the CBN confirmed the Sukuk's liquidity status, making it an eligible asset for banks' liquidity ratio computation. In August, the CBN released another regulation to support liquidity management in the industry by providing intraday and overnight liquidity to non-interest banks using Sukuk and other eligible assets as collateral. All of these developments especially set the stage for the most anticipated offer of the year – Nigeria's maiden federal government Sukuk.

The offer of the federal government of Nigeria's NGN100 billion Sukuk opened in September and was oversubscribed by 5.8%. The Sukuk facility was patronized by a broad spectrum of investors comprising pension funds, banks, asset managers, government agencies, corporates and retail investors. The utilization of the Sukuk's proceeds on road infrastructure added to its public appeal, and fed into the government's narrative of funding its NGN2.1 trillion (US$5.85 billion) budget deficit.

The oversubscription of the offer as well as the wide range of participants have firmly established Islamic finance as a vital and credible industry in Nigeria.

Preview of 2018

In 2018, we expect the continued growth of the Sukuk market as some state governments and corporates have already indicated interest in issuing Sukuk to fund their projects. The federal government of Nigeria is also expected to return to the Sukuk market to fund its infrastructure deficit, and may also consider a eurobond Sukuk.

We also anticipate the licensing of more commercial and microfinance non-interest banks and an increase in Takaful operators.

Conclusion

Without a doubt, 2017 will be recorded as a turning point in the Islamic finance industry in Nigeria. The enhanced regulatory framework for the industry and the advent of a sovereign Sukuk issuance have established the industry. More industry participants and a wider variety of instruments are critical to its success. Building on the benchmark created by the sovereign issue and the asset-backed nature of the Sukuk, it is hoped that the corporate sector will participate in the market. At this nascent stage, it is our view that the infrastructure of the fledgling industry should be built up with specialist training, while efforts must be made to continually inform, educate and enlighten both the public and scholars. Overall, 2017 was a most significant year which portends interesting and exciting times ahead for Nigeria.

Offshore jurisdictions to continue as domiciles for Islamic finance investment

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Islamic finance grew strongly in the first half of 2017. We witnessed numerous Sukuk issuances into the international markets, which commonly featured special purpose issuing vehicles domiciled in popular centers such as the Cayman Islands, Jersey and the Dubai International Financial Center (DIFC). Growth appears to have slowed somewhat during the second half, as oil prices remained consistently low and currencies of certain nations depreciated or were devalued. Some believe that the slow growth in Islamic finance is likely to continue into next year and possibly beyond.

Review of 2017

Notable Sukuk issuances by sovereigns, financial institutions and large corporates took place during the year. The Kingdom of Saudi Arabia (KSA) had a spectacularly successful US$9 billion issuance of Sukuk into the international market, which was structured using a Cayman Islands subsidiary company. The prospectuses of KSA Sukuk Cayman Islands SPVs were also used in issuances of listed Sukuk by large GCC-based corporates such as Ezdan Holding Group, Dar Al-Arkan Real Estate Development Company and DAMAC. However, the issuing vehicles in these latter transactions were structured in the more customary manner as ‘orphan’ entities, with their shares held by a licensed trust company on a charitable trust and their management provided by independent directors. Labuan continues to be a popular issuer domicile for issuances out of Malaysia.

“No matter the type of investment or product, the trend of using offshore jurisdictions as domiciles for investment and issuing vehicles in Islamic finance transactions will certainly continue”

The trend from 2016 of GCC banks raising Tier 1 capital by way of Sukuk issuances in order to satisfy the stringent requirements of Basel III continued into 2017, with Warba Bank issuing US$250 million in perpetual Tier 1 capital certificates in March, followed by domestic private placement Sukuk issuances by Saudi Investment Bank and National Commercial Bank a few months later. Warba Bank utilized the customary Cayman Islands orphan issuing vehicle, but DIFC special purpose companies have also been a popular alternative for issuers of Tier 1 capital certificates.

In addition to Sukuk, there have been a significant number of GCC-based Islamic financial institutions forming Cayman Islands SPVs for hedging transactions in order to take advantage of that country’s netting-friendly legislation. The formation of these subsidiary companies is particularly useful for those Islamic banks situated in jurisdictions where the local laws do not recognize set-off and netting rights.

Preview of 2018

Despite the lack of reported activity by the aviation sector in the Islamic capital markets in 2017, we see this as a growing area for Islamic finance. Following Sukuk issuances by flydubai, Emirates and Etihad in 2014, 2015 and 2016 respectively, we anticipate further airlines and/or aircraft lessors to tap into the Islamic capital markets in 2018 using similarly structured offshore SPVs as issuers.

Several airlines and aircraft lessors are already transacting with Islamic banks that are offering Shariah compliant asset-financing products based on Ijarah structures. This activity will most definitely continue into 2018, with such products using both on-balance sheet and off-balance sheet SPVs domiciled in centers such as the Cayman Islands, Ireland, the DIFC and the Abu Dhabi Global Market (ADGM) to acquire and hold the aircraft and act as limited recourse borrowers.

In terms of GCC financial institutions, as more of them become compliant with Basel III, one would expect that Tier 1 capital Sukuk issuances would become less frequent at least for a period of time. We do see the trend of GCC banks forming Cayman Islands SPVs for hedging purposes continuing into next year.

In terms of GCC corporates, a recent PwC study revealed that working capital performance has deteriorated for large corporates in certain regions of the GCC. We may witness an increase in issuances in the Islamic capital markets or simply an increased demand for Shariah compliant financing to ease pressure on liquidity. In either case, we anticipate that issuer/borrower vehicles will be formed for these purposes in popular centers such as the Cayman Islands, the British Virgin Islands and the DIFC that offer low-cost, English law-based creditor-friendly legislative regimes, experienced judiciaries and political stability.

The considerable liquidity that remains in the market will drive the launch of new Shariah compliant funds by financial institutions and asset managers who wish to offer a diversified portfolio to their client base. These funds will likely continue to be based in offshore centers such as the Cayman Islands, Luxembourg and Jersey, each of which can offer an efficient and effective regulatory framework, a community of highly qualified professional advisors as well as a low (or no) tax regime.

The continued growth of the ADGM and its impact on Islamic finance will be interesting to watch next year, as ADGM SPVs may offer a viable alternative to SPVs formed in the DIFC and traditional offshore centers for use in Sukuk issuances and other Shariah compliant financing transactions.

One way in which offshore centers could advance Islamic finance (and possibly set themselves apart from other jurisdictions) would be to further evolve their legislation to accommodate Shariah compliant transactions and to address, for example, regulatory issues that arise in the structuring of Islamic finance transactions.

Conclusion

While there are contrasting views in the marketplace as to whether growth in Islamic finance will slow down or maintain its steady impressive pace next year, there remain much liquidity and interest in Shariah compliant investment and financing products. No matter the type of investment or product, the trend of using offshore jurisdictions as domiciles for investment and issuing vehicles in Islamic finance transactions will certainly continue.

Oman – a country of untapped potential

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Oman believes in caution and thinks twice it leaps. The same can be said in the case of Islamic finance. Islamic banking was launched in late 2012 followed by Takaful in 2014. Now Islamic banking has 11% of the market share and Takaful 10%. Even in times of economic slowdown, Islamic banking continues to grow at a steady pace.

Review of 2017

2017 has been a challenging year for the economy as reflected in a downgrade of Oman's sovereign credit rating by rating agencies in July followed by a change in the banking sector outlook to negative in September. Sluggish economic growth mainly due to low oil prices has increased the already-wide fiscal deficit which in turn has worsened liquidity scarcity. The government is endeavoring to control spending and raise funds from international markets. The Omani economy, in general, is going through a transformation to minimize the reliance on oil and in line with this, the government launched an economic revamping initiative called 'Tanfeedh' which means implementation in Arabic. It is a five-year development plan from 2016 to 2020 which mainly focuses on the diversification of the economy away from carbon. During the first half of 2017, non-oil revenue grew by 14% as compared with 2016. In 2017, corporate tax increased from 12% to 15% and also across the GCC.

Stock indices, in general, remained under pressure, and the Shariah compliant stock market index lost 16% in 2017. Core assets of conventional banking remained flat and grew by only 1.5% during the period until July whereas assets of Islamic banking increased by 39%. Growth by Islamic banks was equally distributed between windows and fully-fledged Islamic banks.

Windows continue to have 68% of assets of Islamic banking, with Meethaq (the Islamic banking window of Bank Muscat) having a significant chunk. With no defined method to determine the cost of operation of windows, a comparison of profitability is subjective.

In 2016, we saw banks introducing Wakalah Bi Istithmar-based products on both financing and deposit sides and they were well received. Islamic banking reached a significant milestone in 2017 when Meethaq raised funds through the issuance of Sukuk. The issue size was OMR25 million (US$64.7 million), but Meethaq exercised a greenshoe option to an increased total of US$115.84 million. The government of Oman's US dollar-denominated Sukuk facility worth US$2 billion was issued in June 2017, priced at 35bps as orders received were three times the issuance size.

Preview of 2018

Value-added tax will be implemented from 2018 which will result in inflation and a reduction in subsidies from the government, and which will in turn result in lower spending power. With the government borrowing to finance the deficit, this will reduce liquidity for private sector growth and will slow the growth of retail banking.

Another significant regulatory change for the banking sector is the implementation of IFRS 9 in 2018 which could result in higher provisioning. The Central Bank of Oman (CBO) deferred the Basel III requirements to increase capital to accommodate the 2017 capital conservation buffer of 1.25% for a few years but now the capital requirement will increase by 0.625% in 2018 and by another 0.625% in 2019.

The Takaful industry overall is still struggling to capture a significant market share with regulatory and accounting issues. With only two players and a restrictive window structure, growth of the sector has been limited

Local talent development is the most significant challenge as scarce trained human capital is an ongoing challenge for the Islamic finance industry. Local educational institutions are working to bridge the gap between academic and industry requirements.

Islamic finance only accounts for a small part of the economy of Oman. Other members of the GCC have a much more significant share of Islamic banking like Saudi Arabia which has a share of 51%, Kuwait 39%, Qatar 27%, Bahrain 22% and the UAE with 20%. It shows the potential but also highlights the challenges.

Oman needs to come up with an innovative model of Islamic finance. Its economic, socio and political scenarios and policies may seem similar to other GCC countries, but in reality, they are unique.

Conclusion

So far, the service delivery and customer outreach of Islamic finance have been through the traditional channels of brick and mortar. This by definition is keeping the cost of operation on the higher side and making growth very slow. Being new and with no traction toward traditional banking channels, Islamic banks should take advantage of technology-based channels and the fintech boom. The peer-to-peer model is said to be tailor-made for Islamic banking and Islamic banks can develop a financial intermediation model with blockchain technology becoming mainstream.

The regulators have always exercised a prudent, cautious and sound risk management approach. Islamic banking is facing similar challenges from the regulators. Both the Capital Market Authority and the CBO must actively collaborate with industry players to smoothen the bottlenecks in the approval process of new initiatives and diversification efforts from market players.

Oman's most significant competitive advantage is that it was the last to enter the Islamic banking market and thus, it has inherited the knowledge and experience of other countries from all over the world in terms of Islamic banking, especially other GCC countries. Oman should leverage on that and move fast in decision-making, implementation and innovation and reap the true potential of Islamic banking.

Pakistan moving toward greater strength and stability

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Satisfactory growth is seen within Pakistan's Islamic finance industry and this growth momentum has been maintained successfully during the last several years. Pakistan has strong potential for Islamic finance because of its large Muslim population which makes it one of the most active and effective players in the global Islamic finance industry, remaining at the forefront in developing and promoting Islamic finance. Through sound regulatory policies and the solid foundation of the State Bank of Pakistan (SBP), Islamic banking has been able to achieve impressive growth on a year-on-year basis.

The notable growth of overall Islamic finance would not have been possible without the committed and dedicated efforts of the SBP and the Securities & Exchange Commission of Pakistan (SECP) as well as the firm commitment and determination of the government of Pakistan toward the development of conducive infrastructure for the growth of the Islamic finance industry within the country.

Review of 2017

The relaunch of Islamic banking in Pakistan has proven to be a big success as the industry which started from almost scratch now constitutes around 12% of Pakistan's banking system. The sustained growth momentum provides strong evidence of growing acceptability of Islamic banking as a viable and competitive alternative to conventional banking.

According to the Islamic Banking Bulletin of the 30th June 2017, the network of Islamic banking comprises 21 Islamic banking institutions, five fully-fledged Islamic banks and 16 Islamic banking divisions in conventional banks with a total branch network of more than 2,320. As per the bulletin, Islamic banking continued its growth momentum and witnessed a 16.6% expansion in assets while its deposits increased by 17.7%.

During the year, the SBP took various steps for the growth of Islamic banking in Pakistan and a number of the key initiatives were as follows:

- Issued detailed guidelines for the conversion of a conventional bank into an Islamic bank
- Appropriate amendments made in the Shariah governance framework for external audit reporting
- On the recommendation of the SBP, tax neutrality was allowed by the government of Pakistan, and
- Musharakah and Modaraba-based financing were exempted from the requirement of using KIBOR as a benchmark rate.

Similarly, the SECP also played a leading role in the promotion of Islamic finance through the non-banking and capital market segments by regulating important elements of the Islamic finance industry, including Modarabas, Takaful companies and windows, Islamic mutual and pension funds, Shariah compliant REITs and Islamic capital markets. Some of the notable contributions of the SECP are as follows:

- Sukuk (privately placed) Regulations, 2017 were notified
- Arranged a number of sessions on Islamic finance for public awareness, and
- Developed an Islamic share financing product at the Pakistan Stock Exchange to facilitate the Shariah compliant financing of stocks.

Within the SECP, Islamic mutual funds, Modarabas and Takaful companies are performing very well, particularly Modarabas in the promotion of Islamic finance within the country. With its unique nature of a Shariah compliant corporate entity, this model has completed almost three decades of business operation within Pakistan's financial market. During the year, two new Modarabas entered the sector through the public flotation of their Modaraba certificates.

The growth of Shariah compliant investment funds in Pakistan is also helping to encourage demand for Sukuk and other Shariah compliant instruments which provide corporate entities new funding options. Recently, a few well-known firms successfully issued Sukuk, ie Byco Oil Pakistan, Ghani Gases and Fatima Fertilizer. Similarly, Dubai Islamic Bank and Al Baraka Bank also issued Tier 2 Sukuk for their capital adequacy requirements. The government of Pakistan is also planning to issue foreign currency Sukuk in the international market at a value of US$1 billion.

The Islamic Finance Department which was established two years ago has carried out functions of Shariah regulation and compliance, product development, market awareness, the development of the Shariah securities market and the formation of new laws and the amendment of existing laws. The department also provided technical expertise to all operational departments to regulate the Islamic financial services industry. The Islamic Finance Department is currently working on the introduction of a holistic Shariah governance framework that covers guidelines for the entire Shariah compliant segments under the supervision of the SECP.

Preview of 2018

Pakistan's Islamic finance industry can be divided into five major components: Islamic banking, Sukuk, Islamic fund/asset management, Takaful and Islamic microfinance. Out of these, Islamic banking is the greatest contributor within the Islamic finance industry; however, there is still a large untapped area covering both banking and non-banking segments.

The China-Pakistan Economic Corridor project comprising a significant number of large infrastructure and energy projects on a route across Pakistan to the border of China is broadly expected to bring the full potential of Islamic finance into infrastructure funding. These projects will also have support to raise funds through Sukuk and other Islamic finance instruments.

Conclusion

The Islamic finance industry in Pakistan has the potential to be a major contributor to the growth and broad-based development within the country due to its close link with real economic activities. There is a natural connection between Islamic finance principles and responsible finance. The aim is to create a more equitable financial system that should have a positive and tangible impact on the economy and people at the grassroot level. Since its relaunch, Islamic banking has mainly focused on urban and semi-urban areas where financial services are widely available whereas a significant percentage of the faith-based population are voluntarily excluded from financial services, signifying huge potential for Islamic finance within the country.

The Islamic finance industry through its participatory mode of financing can penetrate underserved sectors like agriculture, SMEs and low-cost housing. These sectors are very important in terms of their contribution to the masses and support for sustainable growth, employment generation and overall economic development of the country.

Prospects for Islamic banking in Palestine

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Islamic finance is fairly new in Palestine if compared with the longer presence of the global Islamic finance practice worldwide. This may be attributed to the special situation of Palestine and the challenges it faced until it had its own financial system and regulator post the Oslo peace process in 1994. Arab Islamic Bank was the first Islamic bank to be established in Palestine in 1995 and this was followed one year later with the establishment of another Islamic bank; the Palestine Islamic bank. A third bank, Al Safa-Bank joined the network of Islamic banks in 2016.

According to the Palestinian Monetary Authority (PMA), assets of Islamic banks grew at an average annual rate of 13.6% between 2007 and 2016 compared to 9% for conventional banks. Their assets at the end of 2016 totaled US$1.69 billion, and these assets represent 12% of total assets of banks operating in Palestine, compared with 9% at the end of 2007.

Meanwhile, deposits at Islamic banks grew at an average annual rate of 14.6% compared to 9% for conventional banks between 2007 and 2016. Deposits at Islamic banks totaled about US$1.2 billion at the end of 2016 and accounted for 12% of total customer deposits at banks operating in Palestine compared with 8% at the end of 2007, as per the PMA figures.

In parallel, Islamic banks' equity grew at an average annual rate of 15.6% between 2007 and 2016, compared to 11% for conventional banks, according to the PMA. It totaled about US$243.4 million at the end of 2016 and accounted for 14% of the total equity of banks operating in Palestine, compared with 11% at the end of 2007.

The portfolio of assets is divided as such: 47.7% for Arab Islamic Bank, 46.6% for Palestine Islamic Bank and the rest 5.8% for Al-Safa Bank.

"It is projected that by 2020, Islamic banks are going to gain a market share of around 24%, as per the growth trends of 2015 and 2016"

Review of 2017

Islamic banks are steadily growing more stable and gaining new market share; by the end of the first half of 2017 (H1 2017), the market share for assets increased to reach 13% compared with 12% by December 2016 with a growth percentage of 1%, representing 25% of total market growth during H1 2017. Public deposits dominated 28% of total market share for the same period; while direct financing registered 22% of market growth.

This growth in Islamic finance is split among three Islamic banks in Palestine: 52% of Islamic finance growth in assets is related to activities of Arab Islamic bank, while 39% is attributed to Palestine

Islamic Bank with the remaining 9% attributed to Al-Safa Bank. Growth also took place in terms of deposits with Arab Islamic Bank reaching 58% of total Islamic banking deposit growth and 16% of total growth among Palestinian banks, while Palestine Islamic Bank registered 39% of growth in deposits and Al-Safa Bank 3%.

As far as direct financing is concerned; Islamic financing saw a remarkable growth with Arab Islamic Bank having a 59% share of financing activities and Palestine Islamic Bank with 21% and 20% for Al-Safa Bank.

Preview of 2018

Based on the growth of Islamic finance in Palestine, the forecasts indicate that by the end of 2017, Islamic finance will gain a 14% market share, and if compared against the percentage growth within conventional banks, we could expect that Islamic banks will reach 16% of market share by the end of 2018. The potential for Islamic finance in Palestine is tremendous if we use the same metrics in the region where Islamic finance has a 25% banking market share.

Conclusion

Islamic banking has seen expansion and growth on a global scale since it managed to prove its resilience in the face of all the global economic shocks given its low propensity toward risk, which helped shed light on the vitality of Islamic banking.

Services provided by Islamic banks are able to compete with conventional banks locally and globally, due to the traditional nature of services provided by conventional banks compared to new services and tools provided by Islamic banks that attract existing and new customers.

With the passage of 22 years, Islamic banks in Palestine have a proven record of growth, stability and the ability to compete into the next generation of the banking industry. It is projected that by 2020, Islamic banks are going to gain a market share of around 24%, as per the growth trends of 2015 and 2016.

Legislative initiatives for Islamic banking and finance in the Philippines

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The march toward a general legislative framework for Islamic banking and finance in the Philippines has regained momentum with the filing of Senate Bill No 668 which, if enacted, will be known as the Philippine Islamic Financing Act. A complementary legislative initiative is the proposed Bangsamoro Basic Law (BBL) which contains enabling provisions for the development of Islamic banking and finance in the Philippines.

Review of 2017

2017 can be considered as a promising year for Islamic banking and finance precisely because of the two aforementioned legislative initiatives The declared state policy in the proposed Philippine Islamic Financing Act is the promotion and acceleration of the socioeconomic development of the nation, by the formation of other Islamic banks in addition to the Al-Amanah Islamic Investment Bank of the Philippines (AIIBP), as well as the opening of Islamic banking units or windows within conventional banks, which will "perform banking, financing and investment operations and establish and participate in agricultural, commercial and industrial ventures based on the Islamic concept of banking".

Implicit in this state policy is the need to enhance the capabilities of local institutions in Islamic banking and finance, to be more competitive with their regional counterparts in the light of the ongoing economic integration within ASEAN that envisages qualified ASEAN banks which can operate across national borders of ASEAN countries.

In line with the declared state policy, the Senate Bill seeks to strengthen the AIIBP (which is currently the only existing Islamic bank in the country) by increasing its authorized capital and improving its governance structure, as well as enhancing its capability to serve a broader market.

One other notable aim of the Senate Bill is "to achieve neutral tax treatment between Islamic banking transactions and equivalent conventional banking transactions". Clearly, the objective here is to level the playing field, so that Islamic banking transactions will not be disadvantaged tax-wise vis-a-vis their equivalent conventional transactions. To this end, the Bureau of Internal Revenue is enjoined to "issue policies and guidelines to implement tax neutrality conducive to the growth of Islamic banking and finance in the country".

Complementing the Senate Bill is the proposed BBL drafted by the Bangsamoro Transition Commission. The BBL, if enacted by the Congress of the Philippines, will become the legislative charter of the Bangsamoro people in the Philippines. In the proposed BBL, the Bangsamoro parliament will be enacting laws on Islamic banking and finance. In this regard, the Bangsamoro government, the Bangko Sentral ng Pilipinas (BSP), the Department of Finance and the National Commission on Muslim Filipinos are mandated "to jointly promote the development of an Islamic banking and finance system, to include, among others, the establishment of a Shariah Supervisory Board and the promotion and development of Shariah compliant financial institutions". For good measure, the proposed BBL requires the establishment, within the BSP, of an Islamic Banking Unit "which shall be headed and staffed by qualified Islamic banking experts recommended by the Chief Minister of the Bangsamoro Government". However, the challenge here is the lack of experts or scholars in Islamic banking and finance in the country.

Preview of 2018

The passage of the Philippine Islamic Financing Act and/or the BBL, hopefully in 2018, will start the process of meaningfully attracting Islamic funds and investments into the country, as these are needed for, among others, the various infrastructure projects of the government, as well as the reconstruction and rehabilitation of the war-ravaged city of Marawi in southern Philippines. Other sectors, notably the National Home Mortgage Finance Corporation, are keen on issuing Sukuk to raise much-needed funds for their respective operations. This finds an explicit basis in the proposed Philippine Islamic Financing Act as it authorizes Islamic banks to issue, with BSP's prior approval, "investment participation certificates, Sukuk and other Shariah compliant funding instruments". Presumably, the approval of the Securities and Exchange Commission of the Philippines will be required for non-banking entities issuing Sukuk for their operations.

"It remains to be seen whether the much-awaited laws will be passed in 2018, but hope springs eternal"

Pending the passage of those two pieces of legislation, the Philippine Stock Exchange (PSE) will continue to update, on a quarterly basis, its list of Shariah compliant companies in order to diversify its investment base. In screening these companies, the PSE observes the standards set by AAOIFI. To be included in the list, a company must meet the following criteria: (a) the company's primary business must not involve any of the prohibited activities in AAOIFI's Shariah Standard No 21 – Rules for Dealing of Shares (such as conventional interest-based lending financial institutions, conventional insurance, mortgage and lease, derivatives, pork, alcohol, tobacco, arms and weapons, embryonic stem cell research, hotel, gambling, casinos, music, cinema and adult entertainment) or, if the company derives income from these prohibited activities, such income , on an aggregated basis, must not exceed 5% of its gross income; (b) the company's interest-bearing debt, as well as its interest-bearing deposits or investments, must not exceed 30% of its 12-month trailing average market capitalization; and (c) the company's accounts receivable must not exceed 67% of that average market capitalization.

Conclusion

The ball is now in the court of the Congress of the Philippines, but President Rodrigo Duterte can underscore the urgency of the passage of the proposed laws by certifying them as priority measures of his administration. It remains to be seen whether the much-awaited laws will be passed in 2018, but hope springs eternal.

Qatar – an unexpectedly tough year

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Another year has flown by, a turbulent year that has not been shy of crises and controversies in Qatar. It cannot be denied that the change in the geopolitical situation in the GCC as a result of a number of countries severing all diplomatic ties with Qatar and blocking all borders (air, land and sea) has raised some concerns and has had an adverse impact on the Qatari economy. However, the State of Qatar's key decision-makers in the banking and finance sector have made reassuring statements about the Qatari economy and have backed those statements with actions that have allowed the economy to remain on a steady course.

Both the governor of the Qatar Central Bank (QCB), Sheikh Abdullah Saoud Al-Thani, and Ali Sherif Al Emadi, the minister of finance, have repeatedly conveyed and affirmed the message that Qatar's banking sector is functioning normally, without disruptions to any domestic or international transactions. They have reiterated that the value of the reserves and investment funds of Qatar are more than 250% of GDP and that there is no reason that people need to be concerned about the future of Qatar during these difficult times. In short, the crisis couldn't have come at a better time.

Qatar's economy was given a boost due to local activity undertaken to fill the gaps created by the untimely exit of regional players. As such, the local sentiment remains strong. The drive toward increasing foreign direct investment has been fast-tracked with entities like the Qatar Financial Center, Qatar Development Bank and the Economic Zones Company taking the lead in pulling in investors to Qatar. There has also been an announcement that Qatar will increase its liquefied natural gas production to 100 mega tonnes per annum (an increase of 30% on current capacity).

Review of 2017

Although the performance of companies listed on the Qatar Stock Exchange (QSE) has been affected year to date, the impact has not been significant. The combined net profit of all companies as of the 30th September 2017 amounted to QAR29.3 billion (US$7.59 billion) versus QAR31.1 billion (US$8.06 billion) for the corresponding period in 2016, a decrease of 5.79%.

> "Government spending will continue to drive forward the economy and mega projects that have played a key role in the growth of Qatar will continue to provide opportunities for local and international investors"

Nevertheless, there were a number of key transactions that occurred on the QSE this year. The IPO of the Investment Holding Group was announced at the end of 2016 and was completed in August 2017, marking the second listing on the QSE in the last eight months following the listing of Qatar First Bank back in May 2016. It is expected that more entities will complete their IPOs during 2018, a trend that will be much encouraged by the local authorities.

The Islamic banking community in Qatar has been following the proposed tripartite merger between Masraf Al Rayan, Barwa Bank and International Bank of Qatar, which will create the largest Shariah compliant bank in the State of Qatar and the third-largest Shariah compliant bank in the Middle East, with assets worth more than QAR160 billion (US$41.45 billion) and a share capital of more than QAR22 billion (US$5.7 billion). The proposed merger remains subject to internal approvals and permission from the Qatar Central Bank, the Qatar Financial Markets Authority and the Ministry of Economy and Commerce.

Qatar Islamic Bank (QIB) issued a US$750 million five-year RegS only Sukuk offering. The Sukuk facility was issued at par with an annual profit rate of 3.25% (payable semi-annually), representing a spread of 135bps over five-year midswaps. QIB also announced the launch of its second series of certificates of deposit, which will be available for individuals and corporate customers in the Qatari riyal and US dollar for different tenors of one and two years. The annual profit of QIB's certificates of deposit in the Qatari riyal is expected to be 3.25% for one year and 3.75% for two years.

Qatar International Islamic Bank (QIIB) recently announced the acceptance by Bank Al Maghrib, the central bank of Morocco, of QIIB's submission for the establishment of a bank in the Kingdom of Morocco in partnership with CIH Bank (Credit Immobilier et Hotelier), a Moroccan bank. QIIB also approved the establishment of a Sukuk program of up to US$2 billion as well as an extension of its approval to issue additional Tier 1 Sukuk nonconvertible into ordinary shares of up to QAR3 billion (US$777.14 million) and approved the increase of the cap of its Tier 1 additional Sukuk from QAR5 billion (US$1.3 billion) to QAR7.5 billion (US$1.94 billion). QIIB also recently announced that it has established a US$2 billion trust certificate issuance program, which was approved by the UK Financial Conduct Authority (FCA) (and is expected to be admitted to the official list of the FCA and the London Stock Exchange soon). The program has been assigned a provisional rating of 'A2' by Moody's Investors Service Cyprus and an expected rating of 'A' by Fitch Ratings.

> "Next year should see the gradual easing of tension as some of the political issues are resolved. This will help to reinvigorate the local economies and the Islamic finance sector in Qatar and its neighbors"

The Commercial Bank of Qatar (CBQ) has entered into negotiations with Tabarak Investments for the sale of the Commercial Bank's stake in United Arab Bank, a publicly listed entity on the Abu Dhabi Securities Exchange. The CBQ owns a 40% share in United Arab Bank. If the current geopolitical situation does not improve, then we expect to see further divestments from local businesses.
During the year, QInvest launched the Magnolia Real Estate Fund and stated that the fund is focused on investing in the fast-growing, income-generating multifamily residential market in the US and it has completed an acquisition of an outstanding asset in Denver, Colorado. QInvest also completed an investment into OneOcean Port Vell in Barcelona, Spain. The investment was made through its wholly-owned subsidiary BOH, and was made in conjunction with an investment partner.

During the year, Qatar National Bank (QNB) announced the successful completion of a Formosa bond issuance under its euro medium-

term note program and listed on the Taipei Stock Exchange. Under this program, a US$630 million tranche was issued with a maturity of 30 years callable every five years. This was a Reg S issue. QNB also launched its operations in the Republic of India by opening its first branch in Mumbai.

Preview of 2018

Despite the turbulent year and recent reports and events in the region, the banking sector has largely remained intact and stable. The Qatari market continues to transform and evolve to deal with the regional headwinds faced and it is expected that the banking sector will continue to grow and adapt to the new strategy of the State.

It is hoped that 2018 will see the Qatari economy become more mature, versatile and diverse and the banking sector increasingly resilient. The key developments to watch are the impact of the Qatar blockade and wider regional politics on the whole in the GCC. This will have an impact on the landscape locally and will also dictate priorities for the State. We expect government spending will continue to drive forward the economy and that the mega projects that have played a key role in the growth of Qatar will continue to provide opportunities for local and international investors. What is uncertain is the level of regional investment that may occur next year and this can only be judged as time goes on.

Conclusion

Qatar has had an unexpectedly challenging year in 2017. While oil prices have stabilized and it was felt that the economy would strengthen, external geopolitical events have posed a great threat for all economies in the region.

Things are stabilizing and it is expected that, as is the case elsewhere, Middle Eastern economies will continue to develop such that they become more resilient to political turmoil. Next year should see the gradual easing of tension as some of the political issues are resolved. This will help to reinvigorate the local economies and the Islamic finance sector in Qatar and its neighbors.

Russia – moving forward

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Russia is currently undergoing the first stage of development in Islamic finance, despite the fact that it has a significant (up to 18%) Muslim population. The dominance of conventional finance can be construed as due to low level of financial knowledge and an unfriendly legal environment. In 2017, there were some key events in Islamic finance in the legal and practice field which showed real movement toward fully-fledged Islamic finance activity in Russia.

Review of 2017

Islamic finance development is a very popular topic widely discussed in meetings at the central bank, business circles, forums and conferences. There are significant milestones in Russia's Islamic finance industry which should be mentioned.

The Participating Banking Working Group of the Central Bank of the Russian Federation continued its work on the development of its first roadmap of Islamic Finance which was expected to be realized in December 2017 and a new roadmap adopted for 2018-19.

The supporting role of the Bank of Russia became more active. The regulator continued to examine the possibilities of Islamic finance development not only in banking, but in Takaful and Shariah compliant securities. The representatives of Russian insurance companies should be included in the Participating Banking Working Group of the Central Bank of the Russian Federation and will continue their work in 2018. Some of the first insurance products for Muslims should be offered soon by the Kazan branch of insurance company Allianz.

At the end of the summer, the first Sukuk facility was issued and placed in Russia. On the 25th August, the Central Bank of the Russian Federation accepted and registered the paper. The issuer was an SPV called Sukuk Invest. The volume of the issuance was RUB1 million (US$17,032.4). This pioneer Sukuk issuance can be considered as technical and aims to test the Sukuk-issuing procedures under the local legal environment. The Sukuk issuance was approved by Shariah advisors. The Bank of Russia allowed the use of the floating rate of coupons depending on the profitability of the projects in the Halal industry. Most of them are in the Republic of Tatarstan with a Muslim-majority population.

The legal authorities also took steps for the construction of an Islamic finance-friendly legal system in Russia. The Advisory Council on Islamic finance legislation of the State Duma (Parliament) Committee on Economic Policy, Industry, Innovative Development and Entrepreneurship adopted a special working program for 2017-18. The main objectives of the program are: the implementation of Islamic finance instruments in Russian legal practice and revising Russian legal Acts to make related adjustments.

Another key trend was the significant interest of big banking groups in Islamic finance. In particular, it was announced that Sberbank closed its first deal using Mudarabah and Ijarah to finance the customers of a leasing company in Tatarstan. Together with the government of Tatarstan, Sberbank established the Russian Center of Islamic Economics which will be responsible for promoting Shariah compliant deals and act as a certifying center for producers of Halal goods and Halal services providers. State corporation Vnesheconombank opened its branch in the UAE to support the Halal activities of Russian companies.

Islamic business activity also increased in Russia and abroad. At the beginning of 2017, the International Association of Islamic Business (IAIB) was established in Russia. The chairman of the IAIB, Marat Kabaev, opened the branches of the IAIB in key Muslim regions of Russia and in some Middle Eastern countries. The main goal of the association is to support Russian businesses in developing Shariah compliant activity in Russia and promote Islamic business activity in international deals.

The full translation of AAOIFI Shariah standards from Arabic into Russian, which was made and published in the middle of the summer by the Russian Association of Experts for Islamic Financing, will provide great support to Russian Islamic businesses, state regulators and also students and professors of new Islamic finance educational programs.

In 2017, four universities in Moscow and one in Kazan offered Islamic finance as a full educational program for their students. The Plekhanov Russian University of Economics established and realized a three-month program where the first batch of graduates have received their diplomas and continued using their knowledge in the field of Islamic finance.

All these significant events showed a real positive trend in Islamic finance development in Russia and give hope that Islamic finance will continue to expand in 2018.

Preview of 2018

The regulatory and legal authorities, business circles and academicians have all demonstrated their growing interest in Islamic finance as a fair and socially oriented type of finance. The major events in 2018 include the annual Halal Expo in Moscow, the Kaspiy Expo in Mahachkala and the KazanSummit, which are the key Russian events for the discussion of Islamic finance prospects and developments.

We expect Islamic finance to continue to develop in Russia, speeding up in 2018, the year of the presidential elections in Russia.

However, the sustainable development of Islamic finance in the Russian Federation depends on the practical initiatives of business circles which need constant support from the state authorities. In this respect, the Central Bank of the Russian Federation should coordinate its efforts with parliament whose new legal initiatives can accelerate Islamic finance development to a whole new level.

Conclusion

The Islamic finance industry is showing stable growth but without changing the legislation (including tax rules) in Russia, development will be slow and insufficient. Usually before the presidential elections, the authorities will become more flexible and be open to the demands of the population and business circles. We predict that in 2018, new laws will be adopted to increase Shariah compliant business activity. An Islamic finance-friendly regulatory environment can provide great assistance to Russian institutions to compete with Islamic financial institutions from CIS countries like Kazakhstan and Kyrgyzstan. So the business fraternity should unite its efforts with that of the national state authorities to make a real breakthrough in Islamic finance in Russia.

Saudi Arabia: A country in transition

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Since the inception of Vision 2030 and the National Transformation Program 2020, the Kingdom of Saudi Arabia has recently made significant advances in relation to further kick-starting the economy. Liberalizing the economy, increasing non-oil revenues and improving investors' confidence have been welcomed by the international community and are particularly relevant to Shariah compliant investors as almost all sectors in Saudi Arabia are Shariah compliant.

Review of 2017

The following are some of the most salient measures of 2017 in the various sectors of the economy:

- A new decree to protect minority shareholders in limited liability companies and closed joint stock companies: in April 2017, the Saudi minister of commerce and investment issued a new ministerial decree aimed at enhancing the protection of the rights of minority shareholders of unlisted joint stock and the limited liability companies. The decree supplements the Companies Law which was recently amended in 2016.
- New mergers and acquisitions (M&A) rules: on the 19th October 2017, Saudi Arabia's market regulator, the Capital Market Authority (CMA), approved updated regulations for M&A for Saudi-listed companies, effective upon publication. The new rules are meant to encourage M&A of Tadawul-listed companies and include the regulation of acquisition through the general assembly, the controls over the relevant sales or purchases, the required approach, mandatory offers and disclosure requirements.
- New amendments to the authorized persons regulations and the glossary of defined terms used in the regulations and rules of the capital market: the CMA amended some of its regulations which it said are intended "to develop private equity and venture capital investments, and supporting the asset management industry in Saudi Arabia, in line with the National Transformation Program and Saudi Arabia's Vision 2030".
- New commercial courts in three cities: the Kingdom launched new commercial courts in three cities to facilitate investment as the country continues to diversify its economy. The courts started operating on the 2nd September 2017, and were officially launched by the minister of justice in a special ceremony in October. According to the minister of justice, the commercial courts will help enhance the business environment, encourage and motivate investment in the Kingdom and boost economic development in line with the objectives of Saudi's Vision 2030.
- New implementing regulations of the 2012 Arbitration Law: on the 22nd May 2017, the Kingdom passed the Implementing Regulations of the 2012 Arbitration Law. The regulations came into force on the 9th June 2017. The implementation is considered a significant stride in enhancing the business environment, making it more attractive to foreign investors, and bringing it closer to international norms.
- A new Saudi Arabian General Investment Authority (SAGIA) investors' manual: in May 2017, SAGIA issued a new investors' manual allowing for automated licensing procedures and significantly lower documentation requirements for licensing. The average requirements for documents declined from 21 to two. The agency has been extremely active in 2017. Its semi-annual report for 2017 shows a significant 133% increase in the value of investment projects compared with the same period in 2016. The surge in the figures – from SAR1.39 billion (US$370.43 million) in 2016 to SAR3.25 billion (US$866.12 million) this year – comes as SAGIA issued 158 new licenses in the first half of 2017, up from 127 in the first six months of 2016.
- New draft regulations for private healthcare providers under public consultation: the Ministry of Health (MoH) issued an amendment to its private healthcare regulations and opened these amendments for public consultation. The MoH is also preparing to release an investors' guide to accompany the new amendments. While many expected that the amendment would liberalize the sector for foreign investors, rules pertaining to foreign investment under the new amendment remain unchanged.
- New approval of 100% foreign ownership of companies in the engineering sector: the Kingdom approved the issuance of licenses allowing foreign companies 100% ownership in the engineering services, as well as engineering consultancy, sector. Foreign investors may now seek 100% ownership or operate through a joint venture with a local investor.

Preview of 2018

- The Kingdom is expected to introduce value-added tax (VAT) in 2018 by issuing VAT law and drafting implementing regulations: The Kingdom will introduce the VAT on the 1st January 2018. The VAT is an indirect tax imposed on a broad range of goods and services that are bought and sold by businesses, with a few exceptions. The VAT rate will be set at a standard rate of 5%. Some goods and services will be exempt or zero-rated.
- Privatizations/projects: the Kingdom is preparing for multiple privatizations in sectors including grain silos, hospitals, school buildings, industrial facilities and the power and water sectors. A number of mega projects are also expected to commence, including a further focus on the tourism sector.

Conclusion

The sweeping change in the regulatory environment signals the Kingdom's intention to attract investors. Therefore, investors seeking a Shariah compliant environment are advised to monitor the emerging market status of the Kingdom.

Senegal hoping for miracles in 2018

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While 2017 was referred to as the year of the great offensive or the year of reforms and the taking of positions, 2018 will certainly be a memorable and strategically important year for Islamic finance in Senegal in particular and the West African Economic and Monetary Union (WAEMU) zone in general.

In fact, on the lead of the Senegalese government, the Central Bank of West African States (BCEAO) has had to go through a paradigm shift and embrace diversification in a manner and pace never before imagined.

The era of dependency on a single system looks to be a thing of the past and the move into a dual system has been a key priority.

Review of 2017

During the Africa Islamic Finance Forum held in October 2016 in Abidjan, the governor of the BCEAO announced that the new regulatory framework on Islamic finance will be enforced by the first quarter of 2018.

This optimism was supported by the progress noted in 2017 which led to another announcement made at the last WAEMU Council of Ministers meeting on the integration of Islamic finance in the banking system of the zone.

No later than the 29th September 2017, the Council of Ministers adopted the amendments of law regulating the decentralized financial systems commonly called microfinance in the WAEMU with a view to exercising the operations of Islamic finance effective from the 30th June 2018.

However, it should be noted that these changes are in line with the progress noted in the implementation of the first Islamic microfinance institution in Senegal. In this project, the share capital has been determined, the shareholders are known and several steps have already been carried out while others are ongoing including the submission of the agreement to start its activities. The members of the steering committee to lead the process have recently submitted a request for approval. Hopefully, Senegal will have its Islamic microfinance institution at the beginning of 2018.

To anticipate all these new opportunities, CESAG, the training arm of the BCEAO and one of the leading business schools in West Africa, launched its Master in Islamic Finance program on the 9th October 2017 with 35 students enrolling for the first batch. This program is part of a range of training and research activities that CESAG will undertake, in partnership with the Islamic Corporation for the Development of the Private Sector and other partners, to support the development of Islamic finance in this French-speaking region of the world. However, it should be noted that there were limited seats and thorough participant screening was in place in order to provide quality human resources for Islamic finance.

In terms of Islamic social finance, the Waqf project has seen a lot of progress in 2017 with the appointment of a new director-general and the setting-up of a supervisory committee in the High Authority of Waqf.

A workshop on awareness-raising and experience-sharing was held in Senegal with countries like Morocco, Algeria, Mauritania and Guinea participating.

Preview of 2018

With the concretization of expected changes on banking regulations as well as other key sectors of the Islamic economy such as Waqf and Islamic microfinance, 2018 will certainly be a busy and memorable year for Islamic finance in Senegal and the West African countries.

In fact, with the new regulations which will be published soon, the banking sector will be triggered with the arrival of new banks, with certainly a change in direction in order to embrace the future capital of a majority of the population which until now have been excluded from the banking sector due to their religious beliefs or perceptions. As far as Islamic microfinance is concerned, it is certain that 2018 will be a testing phase. In fact, the "carrots are almost cooked" as the adage says, with the name of the first Islamic microfinance institution in Senegal already in place and hopefully, Senegal will have its Islamic microfinance institution at the beginning of 2018.

The integration of the amendments of law regulating the decentralized financial systems commonly called microfinance in the WAEMU will be carried out with a view to exercising the operations of Islamic finance effective from the 30th June 2018.

As for the High Authority of Waqf, it is currently waiting for confirmation in the budget of 2018 to carry out its activities.

Conclusion

The Senegalese model is paving the way for a successful integration of the Islamic financial system into the banking system and also bodes well for Islamic social finance, including microfinance and Waqf.

It should be noted that with the greenlight given by the government of Senegal, all state departments have included Islamic finance in their innovative funding packages.

The country will not spare any efforts to create favorable conditions for the diversification of the supply of financial products and services such as those of Islamic finance in order to promote domestic credit.

Critical success factors for Islamic finance growth in Singapore


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A national study via a public survey (social media) in 2016 and a closed-door survey of industry players in 2017 revealed the public perception of responsible finance and Islamic finance in Singapore. These surveys were conducted by Pergas Investments Holdings.

Based on 575 public responses, there is growing demand for companies to be socially responsible and ecofriendly without violating human and animal rights. Business activities should benefit society without utilizing industries that are prohibited according to Islam such as alcohol, pornography and tobacco. Ethical financial products offered should also be Shariah compliant and unique.

The pressing financial concerns are healthcare costs, paying off loans, keeping up with the standard of living and retirement. Shariah compliant products are consumers' preferred financial products, according to the survey results. The second survey conducted in August 2017 consolidated 100 responses as shown in Chart 1.

Singapore adopted a level-playing field approach toward Islamic finance and accommodated this sector within its existing single regulatory and supervisory framework. This is one of the root causes for the slow growth of Islamic finance as it has been dwarfed by its dominant conventional counterpart.

As Muslims are a minority, the projected demand for Shariah compliant products is low. This is worsened by the lack of religious awareness to adhere to Muamalat due to the secular environment, making the business unsustainable. With no national agenda to proactively coordinate Islamic finance efforts, the industry seems fragmented. The lack of synergy has caused industry players to carry out such Shariah compliant businesses in limited areas, resulting in silo mentalities.

More than 60% of industry players feel that Islamic finance can grow in investment areas including asset management, funds, unit trusts, structured deposits, real estate and asset-backed securities. The reason is obvious: these are underlying tangible assets and have an affinity to the spirit of risk and profit-sharing. Other promising areas include retail such as savings and current accounts, auto financing, credit cards, property financing and capital markets such as Sukuk, commodity trading and gold.

Review of 2017

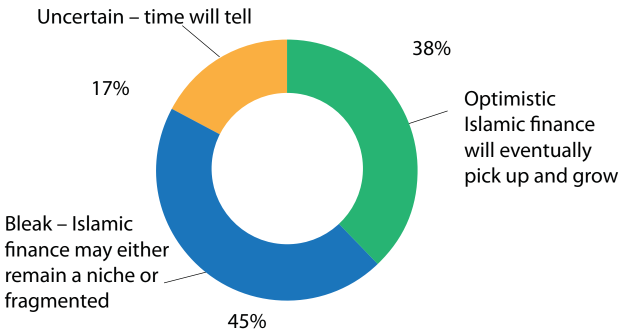
There were few noteworthy developments in 2017 and so much more can be done. See Table 2.

Preview of 2018

For Islamic finance to accelerate in Singapore, the following multidimensional strategies need to be considered:

1. Enhancing the knowledge of local practitioners (both conventional and Islamic finance) and religious scholars on how Islamic finance can contribute to the country's economy – its impact, scale, role and capabilities. Make provision for tertiary Madrasah students to specialize in Islamic economics and finance.
2. Educating the public on Islamic finance to generate demand for Shariah compliant products and services.
3. Understanding the success stories of countries that have implemented Islamic finance and its effects on the financial stability and resilience of the economy.
4. Working with the international community to humanize financial services and effect a paradigm shift, promote financial inclusion and improve financial platform accessibility through fintech and instill ethical mechanisms of trust through latest technological enablers like blockchain. Embarking on fintech to transform areas of capital markets, banking, Takaful, crowdfunding and microfinance could potentially provide better solutions to customers and the industry.
5. Synergizing with multilateral banks or intergovernmental organizations such as the IDB and the World Bank to promote ethical finance. Singapore can consider collaborating with such multilateral entities to demonstrate that finance goes beyond profit maximization and serves the community through alignment with the UN Sustainability Development Goals.
6. Proposing a change in policy affecting Islamic finance (such as a dual banking system, a Central Provident Fund to allow Islamic residential mortgages and broadening the scope of the Administration of Muslim Law Act, among others).

Chart 1: Responses to the question on how Islamic finance will perform in Singapore within the next three years



Source: Author's own

Table 1: Answers of survey respondents to slow growth of Islamic finance in Singapore

Answer choices	Responses
Passive approach by regulator in supporting Islamic finance	69%
Lack of demand and/or supply of Shariah compliant products & services	63%
Societal perception – higher cost of being Shariah compliant and/or low awareness	49%
Market fragmentation and/or players have a silo mentality with no clear market leader	44%
Legislation – Islamic banking and conventional banking are placed at same level playing field	30%
Shortage of local talents	26%
Others (please specify)	19%
Total respondents: 100	

Source: Author's own

As the industry players innovate new business ventures to serve the community, sound ethical principles should be cultivated to produce thought leadership for future generations to emulate and draw inspiration from.

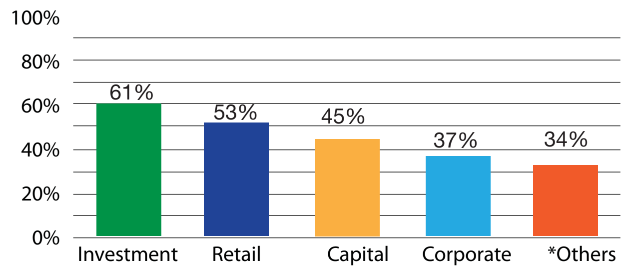
Conclusion

While the industry players must work hard to generate market demand, such fragmented efforts offer little without a governing coordinator from financial regulators or grassroots leaders. Hence, the aforementioned strategies and wishlists can be part of the national agenda to achieve a true global financial hub status.

The journey toward becoming a global financial hub cannot be achieved without having deep, lasting and genuine aspirations for Islamic finance as a key contributor to the nation's overarching strategic plans. The IMF has endorsed Islamic finance whose principles of risk-sharing and asset-backed financing promote macroeconomic and financial stability through better risk management by both financial institutions and customers.

RAM Ratings has reaffirmed Singapore's respective global scale and ASEAN scale sovereign ratings with a stable outlook backed by the country's solid external strength, robust financial profile and strong institutional framework and fundamentals which support and drive Singapore's economic resiliency. Nevertheless, critical structural changes and concerted efforts are required to accelerate and invigorate Shariah compliant products and services to enable them to flourish. Only then will the country be able to withstand financial instabilities from unethical consequences and the inherent cyclical nature of the interest-based conventional financial system.

Chart 2: Promising areas for Islamic finance growth



*Others include crowdfunding, fintech, project and infrastructural finance and Takaful

Source: Author's own

Table 2: Islamic finance-related activities in Singapore

Entities	Activities
Monetary Authority of Singapore	Collaborated with Abu Dhabi Global Market (ADGM) to foster cooperation to nurture fintech entrepreneurship and support innovation in financial services in both Singapore and Abu Dhabi. ADGM also works with Responsible Finance and Investment Foundation (RFI) to promote Shariah compliant fintech services and Islamic finance. Issued a trust license to Hawsford which offers Shariah compliant trust services to private and corporate clients in the country for their wealth needs.
Singapore Exchange	Announced that its Singapore Kilobar Gold Contract has become the world's first Shariah ¬compliant gold futures.
Pergas Investment Holdings (affiliated to Singapore Islamic Scholars and Religious Teachers Association)	Represented Singapore in the Brunei Darussalam Islamic Investment Seminar. Became a participant and signatory of the United Nations Global Impact.
Maybank Singapore	Awarded the Islamic Bank of the Year and Best Retail Bank in Singapore.
RHB Singapore	Hired its Islamic banking team to operate in Singapore, with plans to look at asset management.
Qatar National Bank	Announced its plans to turn Singapore into an Asian hub and expand Islamic operations to other countries including Indonesia, Vietnam, India, etc.
Farringdon	Planned to launch Shariah compliant robo-advisor in Asia, including Singapore.
Arab Banking Corporation	Offers Shariah compliant solutions and has appointed a new general manager for its Singapore branch and head of Asia.
MercyCrowd	A UK-based Shariah compliant real estate equity crowdfunding platform which announced plans to open a branch in Singapore.
EthisCrowd	Launching http://GlobalSadaqah.com, under a Malaysian partnership with Luxembourg's ConexCap, focused on Islamic social finance. Planned launch of a regulated peer-to-peer financing platform in Malaysia in fourth quarter of 2017. Formed a partnership in Indonesia with seasoned Islamic finance leaders from Jakarta and Singapore. Expanded the focus of the flagship EthisCrowd.com to become an investment marketplace that serves the retail crowd, larger private investors and Islamic banks.
Halal Universe	Continues to market IdealRatings equities screening solution to retail investors and Ethica Institute of Islamic Finance's CIFE program. Plans to focus on training and education in Shariah compliant investments and business contracts in 2018.
Ascent Islamic	Conducted a free seminar, open to the public, which addressed the importance of understanding the fundamentals of Riba and Gharar, and that being a debt-free Muslim is not impossible in Singapore. Collaborated with local events management company to create awareness of the importance of children education planning for young families.
Kapital Boost	Set up a representative office in Jakarta in the first half of 2017. Looking to aggressively grow business in Indonesia. Completed its first Islamic invoice financing deal for an Indonesian contractor awaiting invoice payments from PT Telkom, the largest telecom company in Indonesia. Expect to reach 50 crowdfunding deals by the end of 2017. Seeking seed financing to fund regional expansion, after two years of bootstrapping.
Vantisco Global	Planned to launch a Sukuk Fund 18 for retail investors near the end of 2017.
Athenaeum	Updated its product performance for global Sukuk in July 2017 for both institutional and retail investors.
(Company name not disclosed)	An aviation company is considering to issue Sukuk out of Singapore and in early discussions with various industry players to look at feasibility.

Source: Author's own

South Africa's economic challenges may present opportunities for Islamic finance development

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South Africa continues to face severe headwinds on both the economic and political fronts. Having been downgraded in April, it faces another downgrade before the end of the year and has experienced benign GDP growth – 0.7% in 2017 and forecasted to be 1.1% in 2018. On the political front, 2017 has seen yet another finance minister axed, two major cabinet reshuffles and lots of uncertainty around the future of the leadership of the African National Congress (ANC), the political party in power.

Review of 2017

South Africa entered 2017 with a sovereign downgrade looming – but there were positive developments with Pravin Gordhan, the then finance minister, taking a strong stance on state-owned enterprises and launching an SME fund to stimulate growth. But things changed course in March when the cabinet reshuffle took place and Gordhan was replaced. The rating agencies, once bitten, twice shy, finally pulled the trigger in April due to the risk of fiscal and institutional deterioration. These suspicions were later confirmed during the announcement of the mid-term budget policy statement in October where no real interventions were taken to stem the widening fiscal deficit and the government debt to GDP ratio which was heading toward 60%.

> "Investment managers who offer lower risk (or less volatile) Shariah compliant alternatives could benefit handsomely in the current market environment"

On a positive note, South Africa came out of the temporary recession it faced in the first quarter and has experienced trade surpluses (exports over imports) for most of the year.

This won't be enough though to avoid a further rating downgrade expected in December 2017 – this time eliminating South Africa from the World Government Bond Index. The effects could be quite severe – with some ZAR100 billion (US$7.02 billion) expected to leave South African shores, the rand is expected to lose material ground, having profound effects on inflation, interest rates and capital markets leading into 2018.

Preview of 2018

The big questions, leading into 2018, are: how much of the bad news is already priced in and how would a positive political outcome help to push South Africa in the right economic direction?

If you look at a number of emerging market countries that went through the same junk status downgrade cycle, you will find that

the market effects (exchange rates, stock markets and such) were most severe in the period leading up to the downgrade and, counterintuitively, markets actually rallied after the downgrade. While this is in no way guaranteed to happen in South Africa, there is certainly a growing circle of analysts who hold this view. With the ANC expected to have its new party leader elected soon, the right candidate would show positive intent to rating agencies and restore some confidence that the economic policy can be expected to move in the right direction.

South Africa is expected to have strong global support, mainly led by a buoyant eurozone as its largest trading partner and by the recovery in Chinese commodity demand.

The drought that gripped South Africa for the past two years has also ended, with a thriving agriculture sector expected to continue into 2018.

Finally, a stable to weaker US dollar expected in 2018 will be positive for South Africa and emerging market currencies in general.

Conclusion

While the current economic uncertainty in South Africa is concerning, it may present unique opportunities for Islamic finance development in South Africa.

The growing fiscal deficit may force the National Treasury to look toward issuing its inaugural domestic Sukuk and second foreign Sukuk. This is a real possibility, especially since recent conventional debt issuance has been far less subscribed compared to the 2014 government Sukuk issuance which was four times oversubscribed.

Investment managers who offer lower risk (or less volatile) Shariah compliant alternatives could benefit handsomely in the current market environment.

Islamic finance in Spain

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In 2017, there has been no legislative novelty aimed at easing the development of Islamic finance in Spain. The same circumstances that make such development difficult have persisted: extra charges, double taxes, double registering and such. A remarkable fact has been the boom of foreign tourism, including from Muslim countries, which has produced a relevant increase in the concern about the Halal certification of products and services. Finally, new initiatives have been promoted in training and institutional areas, extending and expanding the knowledge of Islamic finance and its structures.

Review of 2017

The lack of a parliamentary majority suffered by the party supporting the government has drastically limited the number of new law proposals, and this situation of practical legislative paralyzation will continue in the short and medium term. Changes in the Spanish legislation aimed at easing the adoption of Islamic finance standards and schemes will have to wait. With regards to jurisprudence from the courts and interpretation of the laws by the government bodies (specifically, the Tax Authority), there has been no relevant advance for the purposes of such facilitation.

> “2018 will not be a year of intensive legislative activity and therefore no legal initiatives to ease Islamic finance transactions in Spain can be expected”

Nevertheless, in 2017 there has been a growing concern in Spain regarding the Islamic economy in general and Islamic financing in particular. One of the main reasons has been a boom in the tourism industry, with record numbers of tourists coming from Muslim countries, especially the Middle East and Gulf areas, who look for Halal products and services. This fact, together with the growing Spanish Muslim population as well as the desire of Spanish companies to enter into new Muslim markets, has produced an increasing interest in obtaining Halal certification, which was confirmed at the Expo Halal event that took place in Madrid at the end of November.

Another reason for this growing interest is the increasing number of Spanish companies working abroad with Islamic finance schemes. Some examples include Spanish engineering and construction companies working in the Middle East and Gulf countries, Spanish banks participating in finance syndicates financing projects with Islamic finance tranches, or Spanish credit entities providing import-export guarantees that are requested from time to time to cover the risk of declaration of a facility as non-Islamic.

A direct result of all these elements is an increase in training and institutional initiatives aimed at extending the knowledge of the Islamic economy and finance in Spain. For example, the Instituto de

Empresa business school, which in recent years has been organizing an executive program on Islamic finance in cooperation with King Abdulaziz University of Saudi Arabia, has also launched a new Master in Islamic Finance and Leadership Development program in collaboration with the Islamic Corporation for the Development of the Private Sector.

Other courses and seminars on Islamic finance have been organized by the University of Almeria, the Universitat Oberta de Catalunya and other entities. On the institutional side, Casa Arabe (a public consortium led by the Spanish Ministry of Foreign Affairs and Cooperation) and SCIEF (the Saudi-Spanish Center for Islamic Economics and Finance) launched in June 2017 the Observatory of Islamic Finance in Spain, an analysis and consulting group for the knowledge of Islamic finance, grouping together experts, consultants, law firms and credit entities working or specializing in this field in Spain.

It should also be noted that the CEIEFI (the Research and Study Center of Islamic Economics and Finance), a Barcelona-based private entity, had organized in April 2017 an event titled ‘Scientific Meeting on Applied Islamic Finance’ and promoted the incorporation of CoopHalal, the first cooperative for Islamic financing services, which has launched a Takaful product for burial insurance services.

Preview of 2018

2018 will not be a year of intensive legislative activity and therefore no legal initiatives to ease Islamic finance transactions in Spain can be expected. Nevertheless, growing interest from companies is expected to give rise to new initiatives to extend the knowledge of the Islamic economy, especially in events of a multidisciplinary nature such as Medaweek in Barcelona.

Another new factor to be followed closely in Spain will be the development of Islamic banking in Morocco. The close relation of some Spanish companies with Morocco will entail, in some cases, a first contact with Islamic financing products, which will help Spanish companies to familiarize themselves with Islamic finance.

Conclusion

One can say that 2017 was a wasted year for Spain in terms of positioning itself in the Islamic economy market, but this would be a simplistic view. The growing number of public and private initiatives aimed at extending the knowledge of Islamic finance and familiarizing Spanish companies with Islamic finance reveals an increasing appetite in the Spanish market for these products, which eventually will translate into transactions in the near future.

The changing landscape of Islamic finance in Sri Lanka

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The concept of Islamic banking and finance was first introduced in 1997 by Amana Investments which was later transformed to a fully-fledged Islamic bank and to date, the sole fully-fledged Islamic bank in Sri Lanka. The high point for the Islamic banking industry was when amendments were introduced to the Banking Act No 30 of 1988 in 2005 where Schedules II and IV of the Banking Act were amended to facilitate certain Islamic finance products such as Murabahah and Mudarabah. Further, the Central Bank of Sri Lanka, the apex body that regulates the banks and financial institutions in Sri Lanka, issued regulations in 2005 requesting banks to maintain separate books of account for Islamic finance operations.

Post the amendments to the Banking Act, there has been a gradual growth in the number of players in the Islamic finance industry. These players include state banks, listed commercial banks, finance companies regulated by the central bank and Islamic finance education providers.

In 2011, the industry managed to achieve another milestone when four tax statutes were amended to accommodate Islamic finance transactions. The amendments were introduced to the Income Tax, Economic Service Charge, Value Added Tax and Nation Building Tax Acts and the commissioner general of the Inland Revenue was empowered to issue guidelines to ensure that Islamic finance products are taxed similar to conventional financial products. These guidelines are pending to date.

Review of 2017

A landmark for the Islamic finance industry was the issuance of Sukuk Ijarah worth US$3.37 million by a leading financial institution in Sri Lanka. This transaction saw many industry players (banks and advisory firms) joining hands as trustees, financial advisors, legal advisors and such. The entity was able to secure international recognition by winning international awards organized by Islamic Finance news.

The government has also shown interest in Sukuk issuance where the former finance minister, in reading Budget 2016, stated that in order to reduce borrowing costs, the government will explore Sukuk bonds.

Banks started to enter the Islamic finance industry. The IDB continued to increase its investments in non-member countries and it has become the single largest shareholder of a leading Islamic finance bank with a 29.9% stake in the institution.

There were new products introduced in the Islamic finance industry in 2017 covering various sectors. The Takaful sector now provides Takaful for motorbikes as well as three-wheelers. Education finance was also introduced in the industry. These new products have brought the Sri Lankan Islamic finance industry a step closer to being on par with the conventional finance industry.

Preview of 2018

There are many anticipated changes to the regulatory framework in 2018. The changes include the introduction of a new Inland Revenue

Act, the Foreign Exchange Act and amendments to the Banking Act No 30 of 1988.

There is a possibility that there may be proposals pertaining to Islamic finance being included in the forthcoming Annual Budget Proposals for 2018. Stakeholders are lobbying the government to implement the requisite steps to:

- Eliminate stamp duty for Sukuk Ijarah
- Amend the requisite regulations to list Sukuk on the Colombo Stock Exchange in order to create a secondary market for Sukuk which would facilitate the Sukuk industry in Sri Lanka, and
- Take cognizance of the requirement to make clear rules for non-resident investors to invest in Islamic financial instruments and repatriate the returns.

Stakeholders are hopeful that these developments may take place sooner rather than later, based on a statement that was included in Budget 2016 which mentioned that the government of Sri Lanka will be examining the potential for issuing Sukuk as a means of raising funds at a cost-effective rate.

Regulatory authorities have taken cognizance of the role REITs could play in the real estate industry in Sri Lanka and specifically the Megapolis Scheme being promoted by the current government in the western province in Sri Lanka. Therefore, positive developments are likely in the regulatory framework for REITs in Sri Lanka.

The presence of the Association of Alternate Financial Institutions has provided institutions operating in the Islamic finance industry with a channel through which to make a collective representation to the relevant regulatory bodies in Sri Lanka. This is expected to close the existing lacunae in the Islamic finance industry.

Conclusion

Sri Lanka, a multiethnic country, has witnessed an expansion of the Islamic finance industry in the financial sector. Most of the major financial institutions have entered the domain and the future will witness the arrival of many others into the industry as well. Though modifications to the legal and tax framework have already been implemented, it is likely that the legal and tax framework will be subject to further amendments to facilitate the growth of the Islamic finance industry in the country.

Islamic banking is a game-changer in Tanzania

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2017 marks 10 years since Islamic banking products started to be offered in Tanzania. Quite a lot has happened since the first official launch, from Islamic windows offering limited Islamic financial products within conventional banks to having a fully-fledged Islamic bank in 2011 which offers a wide range of Islamic financial products targeting corporates, SMEs and retail market segments.

Tanzania has remained with only one fully-fledged Islamic bank while one conventional bank has 'stopped' offering Islamic products to new customers.

A lot has changed from 2007 to date and one remarkable development is the continued growth of Islamic banking deposits and assets. The Muslim segment has also continued to show great potential for growth.

Review of 2017

Tanzania's economy has been going through a challenging period since the beginning of 2016. Many have termed it as a deterioration of the economy, but others have considered it as a correction of the economy. Both phenomena have literally impacted all banks in the market and the main crucial area is in the deterioration of asset quality which was marked with a high non-performing loan (NPL) ratio of 9.3% in the third quarter of 2017 compared to regulatory limit of 5%.

Prior to 2016, many areas of the economy witnessed rapid growth such as banks' balance sheets and the real estate sector, just to name a few. With the change in the country's economic direction, the following have been seen: more government focus on tax collections as well as the introduction of new taxes such as the 18% value-added tax on bank transactions; reduced government spending; reduction of government deposits in a few conventional banks; more government investments in some sectors such as aviation – the country's airline, Air Tanzania, has been revived for the purpose of boosting the tourism sector; heavy infrastructure investments into rail, port and road as well as monetary easing as a result of slashing the discount rate by the central bank, Bank of Tanzania. Banks had to find alternative deposits to replace government deposits that were taken by the central bank, and continued cleaning up while reducing NPLs to grow their assets and record a growth in profit.

In the wake of various government measures to correct the economy, Islamic banking was not affected much by the government's deposit withdrawal but rather witnessed a deterioration of asset quality and challenges in deposit mobilization due to stiff competition from the larger players. However, despite Islamic banking having been in Tanzania for the last 10 years and the country having a fully-fledged Islamic bank for six years, there is still a significant unbanked population that should be properly reached and which in turn can improve the performance of Islamic banking in Tanzania.

However, there is an increased footprint with new banking branches opened to target small and middle enterprises in active business areas of the country.

Furthermore, we have witnessed an increase in the number of Islamic banking awareness programs in the country where several conferences and seminars were organized.

Preview of 2018

Since a new government came into power at the end of 2015 and with unprecedented measures to curb corruption and propel industrial development, Tanzania is likely to become a waking giant. The future is bright as those who survive this period would benefit in the years to come.

Aside from policy issues, 2018 will be about what should be done differently. Hence, we are likely to see more initiatives reaching the target market and more innovative products. The Islamic bank and specifically banks with Islamic windows would need to look at a different approach toward their offerings, as the majority of the Muslim society in Tanzania fall under the category of retail and SMEs while those with a corporate status would be targeted by the conventional giants in the market.

Technological platforms and solutions would be another game-changer for Islamic banking. Since the concentration of Islamic banking customers is more on the retail side, a question remains: "How do you reach them?" There are some possible answers such as offering solutions through mobile banking, collaborating with multinational organizations and developing own wallets.

Conclusion

Tanzania's banking sector is expected to remain in tough times for the next few years, but with innovative Islamic products, Islamic banking stands a chance to prosper and grow in the economy. Technological solutions structured as per Shariah requirements would remain key for growth. Looking at the growing Muslim population in Tanzania, huge potential is there to be tapped to maximize returns.

Measures need to be taken to enhance knowledge of Islamic banking and finance for both potential customers and staff of the respective banks.

While focus has remained on Islamic banking, another massive opportunity also presents itself in the form of Islamic insurance; should the government approve proposed Takaful regulations, it will be a game-changer.

Tunisia: Challenges and prospects

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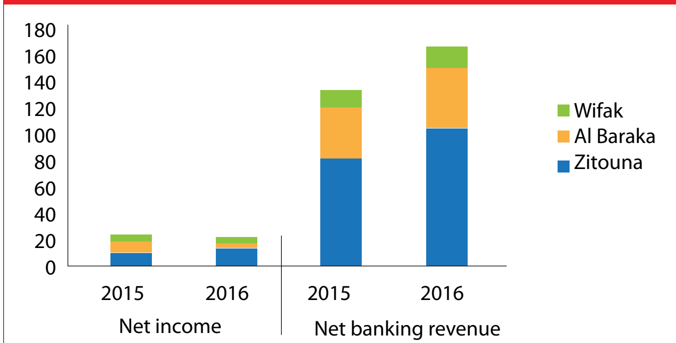
During the last few years following 2011, Tunisia's sovereign rating was downgraded several times by the big three credit rating agencies (S&P Global Ratings, Moody's Investors Service and Fitch Ratings) from investment grade to finally reach highly speculative grade. The latest downgrades in 2017, at the time of writing, came from Fitch ('B+') in February and Moody's ('B1') in August. Accordingly, Moody's lowered Tunisia's banking macro profile to 'Very weak+' from 'Weak-' due to the deterioration in the country's fiscal position, its highly external vulnerability and reduced institutional strength, which was one of the main strengths of the rating.

As a matter of fact, these challenges were captured in the continued decline of Tunisian banks' credit and funding conditions, reflecting the expected impact of the weakening operating environment on both conventional and Islamic banks.

In addition, the planned strategies of the three Islamic banks (Zitouna Bank, Al Baraka Bank and Wifack International Bank (WIB)) which were based on the enabling environment for Islamic finance are also hampered by:

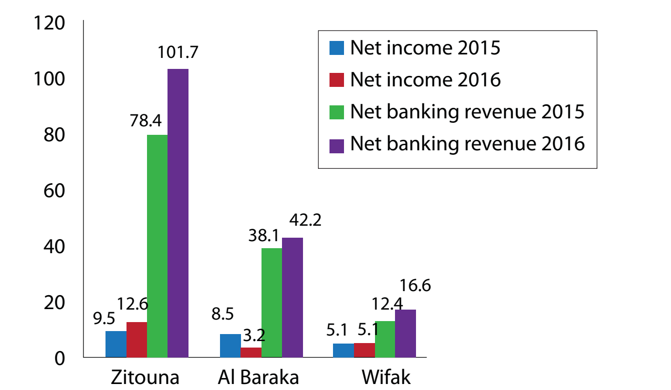
- a delay in the elaboration of a circular by the central bank which will define Islamic finance transactions with reference to new banking laws and provide their regime, and
- a mismatch between Islamic banks' supply and demand which negatively impacts profitability and cash management.

Chart 1: Islamic banking sector's profitability (in million dinars)



Source: Author's own

Chart 2: Islamic banks' individual profitability (in million dinars)



Source: Author's own

Review of 2017

However, the Islamic banking landscape in Tunisia was marked in 2017 by:

- The official launch of the process to sell 69.15% of the capital of Zitouna Bank held by state-owned Al Karama Holding. The selection of a consultant to support the exit strategy, at the time of writing, is in progress.
- The official launch of WIB's activities, following its conversion from a leasing company to an Islamic bank, as a universal bank operating Islamic finance.

The 2016 income statements, published in 2017, showed encouraging signs of improvement in the profitability of the Islamic banking sector as a whole. Individually, Zitouna Bank, which has a 4% share of the banking market, is driving up sector profitability, despite the sharp fall in Al Baraka's net income (down 62.2%) in 2016 due to an increase of provisions for credit losses and salaries and the decline of about half of WIB's normal activity in the 2016 conversion year due to the impossibility of making an early repayment of all outstanding loans.

Instead of issuing Sukuk to improve matching between resource and employment maturities, there have been only three local issuances of seven-year participation certificates (a hybrid title with a fixed part of its yield and a variable part) as follows:

- two issuances concluded by Zitouna Bank: a TND45 million (US$17.8 million) issuance in December 2015 and a TND30 million (US$11.87 million) issuance in June 2017, and
- a TND10.1 million (US$4 million) issuance concluded in June 2017 by Best Lease, which is the only operator in the market of Islamic leasing in Tunisia and a part of the Al Baraka Group.

Actually, Tunisia's use of Islamic finance is increasing, with a primary focus on financing for development through agreements with the IDB which offered nearly US$1.2 billion in funds, used for cooperation in priority areas during the period from 2013-15. The IDB is also fully involved with a pledge of up to TND1.5 billion (US$593.34 million) until 2020 as follows:

- two Murabahah agreements signed in May 2017 to finance the sourcing of natural gas for an amount of US$160 million and to finance the imports of crude oil and petroleum products for an amount of US$150 million, and
- two agreements signed in October to finance the two dam projects at Cap Bon peninsula and Sousse Governorate, with a cost of around EUR72 million (US$83.48 million) (EUR15 million (US$17.39 million) as Qard Hasan) as part of a total cost of about EUR240 million (US$278.27 million).

"It is worth mentioning the value proposition of Islamic finance as an alternative financing instrument for the socially responsible sector and poverty alleviation mainly through Islamic banking structures and innovative products"

Preview of 2018

It is also important to have successful test cases in 2018 to augment Islamic banking's progress and contribute to the Islamic banking industry as follows:

- an IDB program (2016-20) embedded in the international community partnership strategy and once more, an international sovereign Sukuk issuance embedded in the public debt strategy of the five-year development plan (2016/2020) in order to meet government funding needs beyond conventional financing for development and to extend the scale of Islamic products to the private sector
- the development of WIB's activities to gradually get more of the marketplace
- a strategic partner going through the Zitouna sale process to satisfy the needs of corporate clients and project finance, and
- the elaboration by the central bank of a circular which will define Islamic finance transactions expressed in the law and will provide their regime and another circular which defines the conditions for the opening of Islamic windows.

Conclusion

In conclusion, I think it is a good time to take all the legal measures tailored to the Tunisian legal and regulatory environment and to develop all necessary working mechanisms to increase the usage of Islamic finance as a tool to finance infrastructure projects and the private sector.

Also, it is worth mentioning the value proposition of Islamic finance as an alternative financing instrument for the socially responsible sector and poverty alleviation mainly through Islamic banking structures and innovative products.

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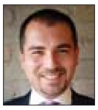
Islamic banking to increase market share through possible participation from Halkbank



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Turkish Islamic banking players usually state that the sector wants to have a higher market share in the Turkish banking sector. The sector's target for 2025 is to reach a 15% market share, according to the Strategy Document 2015-25 issued by the Participation Banks Association of Turkey (PBAT).

The PBAT's general secretary, Osman Akyuz, told Yeni Safak, a Turkish newspaper, that the revoking of Ihlas Participation Bank's license in 2001 and Bank Asya Participation Bank's license in 2016 has caused the Turkish participation banking sector's market share to decrease in recent years but the sector could overcome it with new participation banks such as Ziraat Participation Bank and Vakif Participation Bank.

"With the licenses of two participation banks revoked and only two new ones approved, namely Ziraat Participation Bank and Vakif Participation Bank, the sector needs a new participation bank"

Review of 2017

The Turkish participation banking sector's market share is currently way below the target for 2025. The sector's market share stood at 4.81% as of May 2017; it was 5.5% in 2013. The Turkish participation banking sector's asset size stood at TRY139.4 billion (US$35.94 billion) while the banking sector's asset size reached TRY2.9 trillion (US$747.74 billion) as of May 2017.

Kuveyt Turk Participation Bank is ranked 12th on the Turkish Bank Assets Size Standings, Turkiye Finans is 15th and Albaraka is 16th. No other participation banks were in the top 20.

Kuveyt Turk recorded a net profit of TRY348.56 million (US$89.87 million), becoming the bank with the highest net profit in Turkey for the first half of 2017. The participation banking sector's total net profit stood at TRY769 million (US$198.28 million) corresponding to an annual increase of 35.87% compared with TRY566 million (US$145.94 million) in the same period of 2016. However, Kuveyt Turk's net profit for the first half of 2017 is only 3% of the Turkish banking sector's total net profit. The PBAT's board chairman, Meliksah Uslu, stated that the total funds used reached TRY95.2 billion (US$24.55 billion) corresponding to an annual 7.6% increase while the total number of branches of participation banks reached 990 and they expect this number to increase in the following years.

Kuveyt Turk has a satisfactory financial outlook when evaluating the bank's net profit for the first half year on year. The bank's net profit for the first half of 2013 stood at TRY146 million (US$37.64 million) and it climbed to TRY348.56 million in 2017. Turkiye Finans's net profit stood at TRY186 million (US$47.96 million) for the first half of 2017 and it is only TRY36 million (US$9.28 million) more than the bank's net profit for the first half of 2013. Kuveyt Turk is the bank with the lowest net profit increase for the first half of the year during the last five years.

Preview of 2018

There have been a lot of positive developments in the Turkish participation banking sector over the past 12 months but the sector must be evaluated according to the 15% market share target for 2025 meaning that there must be a higher market share increase in the following years. With the licenses of two participation banks revoked and only two new ones approved, namely Ziraat Participation Bank and Vakif Participation Bank, we can say that the sector needs a new participation bank. Halkbank, a national bank, is expected to open a participation bank soon.

As mentioned previously, in May 2017 the market share of the participation banking sector was 4.81% which is the same as in 2016 and thus is not sufficient to meet the sector's target. Turkey got over a coup attempt on the 16th July 2017 and it is normal for the participation banking sector not to be able to have impressive developments over the last year. Like Osman said, the sector in 2018 could possibly be better based on the sector's numbers for the first half of 2017. For instance, as mentioned previously, the participation banking sector's asset size reached TRY139.4 billion as of May 2017 corresponding to an annual 7.7% increase while its net profit for the first half of 2017 increased 35.87% more than in the previous year.

Conclusion

Halkbank is expected to enter the participation banking sector in order to increase the market share of the participation banking sector. However, on the 26th February 2017, Turkey's president, Recep Tayyip Erdogan, stated that there has been a delay in Halkbank entering the participation banking sector. However, he believes that when it happens, it will expedite the development of the Turkish participation banking sector with Islamic finance developing quicker than usual.

Islamic finance growth outpaces conventional counterpart in the UAE

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Islamic finance in the UAE has had a strong year of growth; however, compared with the previous years, momentum has slowed somewhat in response to the slowing economy. The drop in oil prices and cuts in government spending on new projects have reduced loan growth and while liquidity in the banking sector improved amply during the year, Sukuk issuance lacked the pace to absorb this liquidity.

Review of 2017

Assets of Islamic banks in the country grew by 8.5% to reach AED533 billion (US$145.08 billion) which represented a 20.3% market share of the total banking sector assets as at September 2017. In contrast, conventional bank assets grew by only 3% to AED2.09 trillion (US$568.91 billion). In response to the economic turn, there was an increase in the restructuring of loans during the year, even though reported non-performing loan (NPL) ratios have not shown material deterioration as yet.

> "Looking ahead, the pace of asset growth for Islamic banks may continue to slow further as currency strength and weak economic growth hamper prospects for lending to corporate and retail sectors"

Growth in gross Takaful contributions also slowed during the year. Insurance penetration in the UAE is low compared to the developed world; however, recent regulatory actions such as the introduction of a compulsory health insurance scheme in Dubai is likely to create growth opportunities.

Contrasting the growth in Islamic financings and insurance products, Sukuk issuance actually declined during the year. As at the end of the third quarter (Q3) 2017, the UAE reported a total of seven Sukuk issuances amounting to US$3.33 billion compared with US$7.8 billion in all of 2016 and US$4.35 billion in 2015. The waning enthusiasm for Sukuk is partly attributed to the concerning development of Dana Gas challenging the legality of its own Sukuk which has left holders of the US$700 million Dana Gas Sukuk across two tranches in a bit of a limbo. Though the final impact on markets will depend on the ultimate judgment passed on the case, Sukuk investors and issuers are sitting on the sidelines for the time being.

The year 2017 also included the launch of the Emirates NBD Markit iBoxx USD Sukuk Index in Dubai (Bloomberg ticker IBXXENDT Index) that tracks over two-thirds of the global Sukuk universe. It includes all US dollar-denominated Sukuk greater than US$250 million in size and greater than one year in maturity. The index excludes Tier 1 securities and also the 100% Murabahah securities.

The GCC represents the largest segment (52%) in the index followed by Indonesia (15%), supranationals (10%) and Malaysia (9%). The total return index started with 100 as the base as at the 1st January 2013 and was at 118.22 as at the end of Q3 2017, reflecting a yearly return of circa 3.4%.

The diplomatic row among the GCC countries that began in early June over Qatar's alleged involvement with terrorist groups impacted markets throughout the the second half of 2017. This is negative for GCC debt markets in general, not just for the Islamic finance industry or just for Qatar, the UAE or Saudi Arabia. The sale and distribution of bonds and Sukuk from Qatar into the UAE and vice-versa became somewhat complicated and the placement of funds from UAE-based banks into Qatari banks reduced during the year.

Preview of 2018

During 2017, the UAE welcomed further details on the upcoming 5% value-added tax (VAT) starting in January 2018. Financial services including Islamic finance products are likely to be subject to VAT though every product may not be at the highest rate of 5%. Detailed aspects of the tax implementation will emerge in due time.

The focus on promoting the Islamic economy in the UAE is expected to remain at the forefront of the government's strategic plans. Early in 2017, the Dubai Islamic Economy Development Center adopted the four-year plan covering the period of 2017-21. As part of the plan, the government will continue to work toward engaging in and encouraging the development of the Islamic economy in the country. As part of the continued efforts, Dubai Financial Services Authority and Securities Commission Malaysia have signed an agreement to cooperate in the development of fintech innovation. The Dubai Gold and Commodities Exchange (DGCX) is also in the midst of developing the region's first Shariah compliant spot gold contract. The DGCX is partnering with Saudi conglomerate Ayedh Dejem Group to make the US$7.5 trillion gold market more investable for funds and investors who follow Shariah principles.

Conclusion

Looking ahead, the pace of asset growth for Islamic banks may continue to slow further as currency strength and weak economic growth hamper prospects for lending to corporate and retail sectors. NPLs may increase and profitability may come under pressure if funding costs rise materially in response to the interest rate hikes in the US. Growth in Sukuk issuance is likely to remain sideways. On the regulatory front, we expect positive developments and ongoing improvements in standardization/homogenization in Islamic finance and further growth overall in the Islamic economy in the UAE.

The UK strengthens its position as Islamic finance center

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Islamic finance in the UK has continued to grow despite the economic uncertainty in the aftermath of the Brexit vote in 2016 and the snap election in June. Islamic banks continued to demonstrate continued strength with record earnings from Al Rayan Bank, the country's largest Islamic financial institution by assets. The first Shariah compliant crowdfunding company, Yielders, was approved by the Financial Conduct Authority, opening the way for other Islamic start-ups to meet the investment, banking, and financing needs of over three million Muslims across the country.

Review of 2017

Boardroom conversations over the past year have swirled around the impact of Brexit on the financial services industry as an exit from the EU could result in tens of thousands of job losses in the sector as firms shift operations into the EU. However, concerns about London losing its dominance as a global financial center appear to be overblown as the sector continues to show resilience and particularly the Islamic finance industry is growing stronger by the day.

The UK made history in the summer of 2017 with the Royal Mint becoming the world's first mint to achieve compliance with the Shariah standard on gold set out by AAOIFI. Considering the standard was developed in cooperation with the London-based World Gold Council, the UK clearly leveraged its leadership in commodity trading to attract Islamic investors who can now use the service to buy, store and sell the Royal Mint's bullion coins and bars securely online.

The Islamic banking footprint in the UK grew in 2017 led by Birmingham based Al-Rayan Bank opening a dedicated commercial banking office in London as well as three retail branches, including in Wembley, Bradford and its first branch in Scotland (Glasgow). The expansion was on the heels of a robust earnings report in which Al Rayan delivered a 32% increase in pre-tax profits and increased the bank's' balance sheet by an astounding 43% year-over-year with total assets of the bank reaching GBP1.4 billion (US$1.85 billion).

In addition to traditional Islamic banks, innovative financial technology (fintech) companies are also starting to take shape in the UK with the first Shariah compliant fintech company, Yielders, getting approval to provide online property crowdfunding investments. Another start-up, Ummah Finance, is planning to launch the country's first completely digital bank and would effectively become the first Islamic challenger bank in the UK if successful.

Preview of 2018

The outlook for the sector remains strong as the CityUK report titled 'Global trends in Islamic finance and UK market' issued at the IFN Europe Forum in London in September further reinforced the sector's confidence in London remaining the leading western center for Islamic finance despite the uncertainty posed by Brexit.

It was at the forum in London that Stephen Barclay, the economic secretary to the treasury, announced in his keynote speech the government's commitment to Islamic finance with the intent to reissue the country's sovereign Sukuk in 2019.

Additionally, there are trials underway for a commodity Murabahah financing product to provide Shariah compliant funding to SMEs across the country. The product is being developed by Liberis and backed by the UK government-supported British Business Bank. This would be one of the first Islamic SME short-term finance products in the UK, and breaks new ground in Islamic finance for UK firms.

Shariah compliant student financings, as well as the potential of regeneration projects across the UK, remain promising areas for Islamic finance to solve in the coming years. We may also see initiatives in Islamic insurance which has remained low-key despite the formation of the Islamic Insurance Association of London several years ago to promote the sector.

Expect to see further breakthroughs in commercial financing and investment products next year with Islamic fintech start-ups taking root to bring innovative solutions to the marketplace, supporting the over 20 banks in the country already providing Islamic products including the five fully Shariah compliant institutions.

Conclusion

Islamic finance has much more room to grow in the UK and offer Muslim consumers and businesses greater choice. The regulations continue to be accommodating and will evolve to allow more innovative fintech solutions to provide digital low-cost alternatives in the marketplace as consumer awareness and the adoption of Islamic finance grow.

The UK no doubt will continue to be the western center for Islamic finance despite Brexit. And it can be argued the distinctiveness of London can perhaps be enhanced by Brexit as it unshackles itself from EU regulation and leverages the depth of its Islamic finance expertise and talent to continue supporting the development of the sector.

Finding a footing in the US

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Islamic finance first gained traction in the US nearly 25 years ago with the first Shariah compliant mortgage offerings sanctioned by the Office of the Comptroller of the Currency and the launch of the Dow Jones Islamic Index in the mid to late 1990s. Since then, much has been made of the potential of the Islamic finance market in the US with little real progress on the ground.

At present, Islamic mortgage and mutual fund companies dominate the market with a few attempts at Takaful and commercial financing companies, with mostly mixed results. There are also recent community initiatives to establish Islamic credit unions that have made some headway but most have not fully operationalized. The hope of course is that a few success stories will lead to other, larger initiatives. While the history certainly does not paint a promising picture, the future may yet be bright. The disruptive forces of fintech and blockchain technology will certainly provide opportunities for entrepreneurs to change the rules of the game, which will invariably include new and bold attempts to reinvent the Islamic finance industry. My hope, and that of many others, is that New York or Silicon Valley may yet become a global capital of the Islamic finance industry.

Review of 2017

At a macro level, 2017 has seen mostly positive economic news for the US markets. The stock market has hit all-time highs nearly 50 times in 2017 alone and has extended a nine-year bull run since the financial crisis, fueled by strong results from FAANG (Facebook, Apple, Amazon, Netflix and Google) and other large cap stocks. The S&P 500 has achieved eight straight quarters of gains, the first such stretch in 20 years. At the time of writing, the Dow Jones Industrial Average was approaching 23,000, which would represent an all-time high and the fourth 1,000-point climb in 12 months, the most number of 1,000-point moves in a calendar year in the 120-year history of the benchmark. The unemployment rate has remained steady throughout the year and fell to pre-crisis lows. GDP growth accelerated in the second quarter of this year to top 3% with expectations that the third quarter will see a similar result.

This is all against a backdrop of rising interest rates – the Federal Reserve has made two rate hikes this year with a third largely expected in December – political and social uncertainty, historic natural disasters and a general unease about the direction of the US economy. Despite it all, interest in US assets remained strong, almost by default.

London is beleaguered by the fallout from the Brexit vote. Europe is still in recovery and currency risk means less appetite for euro assets. Islamic investors still favor real estate where multifamily, logistics, light industrial, storage and retirement properties were all target sectors. Overall, foreign investment in real estate saw an uptick in 2017 with Chinese and Canadian investors leading the way according to the 2017 Profile of International Activity in US Residential Real Estate report from the National Association of Realtors. Yet, anecdotal evidence (there is no hard data specific to Shariah-sensitive investments in the US) suggests that the transaction volume by Islamic investors in 2017 is below that of 2016, continuing a downward trend since 2015. With petrodollars becoming scarce due to depressed oil prices and a 'Cold War' gripping the capital centers of the GCC, this seems to fit the narrative, at least in the short term.

While most observers tend to focus on larger transactions and foreign investment, what is often overlooked are the local, community initiatives that seek to fill a gap in the Islamic offering in the US. As mentioned earlier, progress has been made with credit unions and other finance-related ventures (mainly in the asset management and financial advisory space) to provide retail consumers with Islamic options when none would otherwise exist. We know of at least three credit unions that have filed with the National Credit Union Administration, with the first in Texas being chartered in 2016. Some conventional credit unions offer Islamic banking products in the larger Muslim-populated areas of the US, responding to the demand from their Muslim customers. Other, less formal, community initiatives and cooperatives have been around for decades now. It is our belief that these community-driven initiatives will continue to move the Islamic economy forward in the US, even as international interest in the US vacillates due to political and social volatility.

Preview of 2018

Economists differ about what 2018 and beyond will bring and thus what steps should be taken now to avert any slowdown or bubble. Inflation has remained below the Federal Reserve's target of 2% – a healthy rate as per the Fed's view – with some within the Fed arguing that it should hold off on a further interest rate hike until the inflation target is reached. Investors have already priced in tax and healthcare reform in equity valuations with many asset managers fearing that valuations have only one way to move. In the summer, asset managers were warning investors of an impending crash, whereas the fourth quarter brought more record highs and analysts speaking of market velocity and an 'epic' bull market.

We expect that the Islamic market in the US will continue to see a downward trend both in terms of foreign investment in US assets and domestic initiatives within the space. This is less to do with the political and economic instability here in the US and more to do with the political unease gripping the GCC and the larger MENA region coupled with stagnant oil prices. We do anticipate that new technologies that are disrupting other banking and finance channels will eventually make their way into the Islamic space. We see the Islamic economy being positively impacted by innovations in fintech and the continued investment and development in blockchain and grassroots initiatives to challenge conventional banking and finance (in particular) channels.

Conclusion

The US barely registers on the global Islamic banking/finance/economy charts where it is a blip in the US$1.9 trillion Islamic market. The US usually makes headlines in the context of the capital markets when a large US-based corporate makes a foray into the Sukuk market with a benchmark issuance.

Otherwise, the US represents a frontier market within the Islamic economy – albeit one with tremendous latent potential. With Muslim consumer spending expected to top US$2.5 trillion by the year 2020 and with Islamic financial services continuing a growth trend even outside traditional Muslim-majority countries, it seems inevitable that US market players will jump on board.

It may not be in the traditional sense – think brick and mortar banks or Takaful companies – but may be in more innovative and disruptive ways that use the latest developments in conventional finance channels to redefine the Islamic financial services market.

Strong Islamic finance potential in Africa

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With a double-digit growth oscillating between 10-15% per year and an outstanding amount expected to reach US$3 trillion dollars in 2020, the Islamic finance market has strong potential yet Africa still has difficulty profiting from this potential. Indeed, the continent has a penetration rate of barely 1%. The eight West African countries (Benin, Burkina Faso, Cote d'Ivoire, Guinea Bissau, Mali, Niger, Senegal, Togo) grouped together within a common economic organization called WAEMU (West African Economic and Monetary Union) have finally understood the potential and intend to double efforts to bring this sector into their economy. The growth of Islamic finance thus seems certain in this zone because the BCEAO (Central Bank of West African States), their common financial institution, has decided to accelerate the process.

Review 2017

Islamic and conventional international financial institutions have recently invested heavily in the development of Islamic finance in Africa, especially in the WAEMU zone. The IDB through its subsidiary, the Islamic Corporation for the Development of the Private Sector (ICD), has increased its support for Islamic finance in West Africa via several initiatives.

One of the initiatives is the creation of Tamweel Africa Holding Group which is a partnership between the ICD and Bank Asya, one of Turkey's leading Islamic banks. The objective is to promote Islamic finance in West Africa through the purchase and management of successful Islamic banks oriented toward the financing of SMEs. Subsidiaries of Tamweel Africa Holding include: Islamic Bank of Senegal, Islamic Bank of Niger, Islamic Bank of Guinea and Islamic Bank of Mauritania.

Togo and Cote d'Ivoire have followed in the footsteps of Senegal, the first country in 2014 to issue Sukuk in the amount of US$100 billion, followed by another one worth US$150 billion in 2016.

The IDB also brought financial support to conventional banks in the setting-up and development of products and services of their Islamic windows. Coris Bank Baraka (the Islamic window of Coris Bank International) received a financing line of EUR17 million (US$19.75 million) to finance SMEs and EUR15 million (US$17.43 million) from the International Islamic Trade Finance Corporation, a subsidiary of the IDB, for trade financing. In the same context, Afriland First Bank Cote d'Ivoire, a pan-African trade financing service bank, signed a cooperation agreement to create an Islamic window in Cote d'Ivoire with the ICD in the coming years.

The BCEAO is in the process of establishing a legal and fiscal framework that is more conductive to the practice of Islamic finance in the region. The adoption of this framework was announced in 2017 and is expected to be implemented in 2018.

Preview of 2018

Islamic finance undoubtedly has a place in the African economy because of its ethical and religious dimension and its socially responsible philosophy. It is an opportunity in Africa, with a mainly Muslim population, where the rate of banking is still very low at less than 15%.

In 2018, there are some good prospects for Islamic finance such as the adoption and entry into force of the regulatory framework. Table 1 shows some of the prospects for Islamic finance in 2018.

Conclusion

The West African region represents a non-negligible market with a very large Muslim population, so it cannot remain on the sidelines of the development process of Islamic finance. Looking back over recent years, a lot has been achieved. All these efforts should continue and will enable the region to mobilize considerable financial resources to bring sustainable growth to the continent.

Table 1: Prospects for Islamic finance in 2018

Prospects	**Actions**
Regulatory framework	The regulatory framework undertaken by the BCEAO with the support of the ICD will be implemented during 2018.
Launching of Sukuk	Several countries in West Africa have expressed their interest to issue Sukuk in 2018.
Islamic Fund for Infrastructure Financing in Africa	The objective of the fund is to help solve the following problems: • 40% of the population do not have access to clean drinking water • 60% of the population do not have access to sanitation • only 30% of the rural population has access to roads, and • only 30% of population has access to electricity. Transport costs in Africa are among the highest in the world.
Launching of Islamic finance institutions	Several initiatives are under way within the framework of the creation of banks or Islamic windows in the West African zone. We expect major initiatives by the Coris Bank Group in Benin, Cote d'Ivoire, Mali and Senegal. Also in Cote d'Ivoire, the creation of Afriland First Bank is in progress. Several initiatives are also under way in the microfinance sector in several countries and are expected to be materialize in 2018.
Launching of an academic training program with CESAG Business School	This program is to address the lack of qualified human resources and an MBA in Islamic finance will be introduced in the CESAG program in 2018. A convention on this was signed in January 2017.

Source: Author's own