Islamic Finance – Fastest growing segment of global banking

Bahrain Monetary Agency
Agenda

• Industry Overview

• Opportunities

• What is Islamic Banking?

• Differentiating Factors (Objectives, Human resource, Shariah Board, Products & Corporate Governance)

• BMA’s Contribution to Islamic Banking & Support Institutions
Industry Overview
**Industry Overview**

**Islamic Banking: The Asset-Deposit Break-down**

*Break-up for 2004, based on Annual Report published by General Council for Islamic Banks and Financial Institutions*

Global Islamic banking assets and liabilities are estimated at US$ 170 billion and US$ 140 billion respectively.
Industry Overview


- Statistics on Islamic banking industry are 2003 figures extrapolated from figures obtained from General Council for Islamic Banking & Financial Institutions.
- Statistics on global banking are 2003 figures obtained from Bank of International Settlements publications.
BAHRAIN IS THE HUB OF ISLAMIC BANKING ACTIVITIES

Strong regulatory framework for Islamic banking
- PIRI is a pioneering regulation for Islamic banks - one of the most advanced worldwide
- All Islamic banks in Bahrain are required to file their prudential returns based on PIRI

Home to essential supporting institutions
- International Islamic financial Market
- Liquidity Management Centre
- Accounting and Auditing Organization for Islamic Financial Institutions
- International Islamic Rating Agency
- General Council for Islamic Banks and Financial Institutions

Strong commitment to Islamic banking
- Supporting innovation of new products - BMA Shari’a Advisory Council
- Regular Issuance of Sukuk and leasing securities
- Creation of a deep and broad talent pool through BIBF

No of Islamic Financial Institutions: 26
Full Commercial Banks (5), OBU (3), Investment banks (14), Others (4)
Total Islamic Banking Assets (US$8.2 billion)

And most large banks have their Islamic banking business in Bahrain
- Citi Islamic Investment Bank
- ABC Islamic
- Al-Baraka Islamic Bank
- UBS Noriba
- BNP Paribas
- Kuwait Finance House

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Equity capital markets in the GCC showing tremendous performance, primarily due to:

- Strong oil revenues over last three years
- Low interest rate environment moving investors towards equities
- Post 9/11 capital outflow slow down from the GCC region to Western economies
- Privatization initiatives
Opportunities

Debt Capital Markets

• Debt capital markets developing rapidly especially on the Islamic front

• The regional debt market comprises mainly of government debt

• The value of GCC syndicated loans and Eurobonds between 1997 and 2002 is estimated at around US$ 65 billion

• It is estimated that by 2006, close to US$ 10 billion of Sukuk would be outstanding (currently it stands at US$ 6.4 billion)

Source: E&Y Research and Analysis (from various sources including MEED, Islamic Banker and zawya.com)
Opportunities

Financial Advisory Services

• Region expected to experience greater activity in financial advisory side as a result of:
  – Consolidation of major sectors of the economy (financial sector)
  – Privatization – which may create attractive acquisition targets
  – Family businesses realigning their core operations and divesting other businesses.

• The total M&A deals in the region during the five year period 1996-2001 were recorded at 256 and valued at US$ 8.7 billion
Opportunities
Wealth Management

• Majority of wealth managers in the region are rep offices of global private banks

• GCC private wealth estimated to be more than US$ 1.4 trillion

• Wealth management clientele in the GCC includes:
  – Institutions: Pension and social welfare funds, insurance companies, and government investment authorities;
  – HNWIs: Those individuals who have more than US $300,000 in liquid assets;
  – Affluent Clients: Those individuals who have liquid wealth in the range of US $50,000 – US $300,000.

• Continued creation of wealth, an undersupplied Affluent population and a lack of Islamic focus provide ample opportunities for a new entrant
WHAT IS ISLAMIC BANKING
What Is Islamic Banking

- The subject matter of Islamic banking is the economy.
- Bank earns profit from participating in the economy, by sharing the risk and rewards through pricing of goods, services and benefits.
- Consequently, there are no interest-based contracts.
**General Principles**

- May look and feel the same as conventional banking however the processes are different.
- All financial transactions under Islamic Banking must be representations of sale - goods, services or benefits (except Qard al-Hasan).
- Emphasis is on the minimization of disputes, deception, misrepresentation and unfair trade practices.
**General Principles**

- All transactions involving interest payments are strictly prohibited.
- Interest payment represents the return on transactions involving exchange of similar assets e.g. money for money.
- Time has value that can be discounted only through pricing of goods and services and not interest on money.
- Money cannot be treated as commodity and hence cannot be priced.
- Emphasis is on market determination of prices.
DIFFERENTIATING FACTORS FOR AN ISLAMIC BANK
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- Objectives
- Human resource
- Shariah Board
- Products
- Corporate Governance
DIFFERENTIATING FACTORS FOR AN ISLAMIC BANK

- **Objectives**
  - To implement and materialize the economic and financial principles of Islam in the banking arena
  - Not only to earn profit, but to do good and welfare to the people.
  - To do away with disparity and establish justice in the economy, trade, commerce and industry; build socio-economic infrastructure and create employment opportunities.
DIFFERENTIATING FACTORS FOR AN ISLAMIC BANK

- **Human resources**
  - The principles and working procedures of Islamic banks are completely new and different from conventional banks.
  - There is an inevitable need for **training** of the employees to orient and attune them to the new system of Islamic banking.
  - The management and the staff must be **experienced professionals** with proven track record.
  - The staff and the management must be **committed** to the cause of Islamic banking.
  - Outlook of the institution and staff must reflect the **Islamic identity** requiring a major change in the general attitude of the institution as well as its management.
DIFFERENTIATING FACTORS FOR AN ISLAMIC BANK

● Shariah Board
  – Sharia Board/Council plays a vital role in guiding and supervising the implementation and compliance of Shariah principles
  – Worldclass Shariah Board is important for credibility and for giving proper advice
  – Shariah Advisor is recommended
DIFFERENTIATING FACTORS FOR AN ISLAMIC BANK

• Products
  – Standard
    • Murabaha, Musharika, Mudaraba, Ijara, Istisna, etc.
  – Structured
    • Innovative structures combining two or more products to suit customers needs, such as Sukuk Al Ijara, Istisna etc.
    • Documentation
    • Strict adherence to Shariah compliant documentation and implementation of the process stipulated therein
DIFFERENTIATING FACTORS FOR AN ISLAMIC BANK

Corporate Governance

- Clear understanding of inherent risks.
- Review and approve appropriate policies limiting these risks.
- Ensure sufficient liquidity.
- Appointment of effective Audit Committee (non-executive members).
- Receiving frequent reports.
- Transparency (AAOIFI Accounting Standards).
- Adopting AAOIFI corporate governance standards on Shari’a.
BMA’s Contribution to Islamic banking & Support Institutions
The BMA currently regulates 28 Islamic Financial Institutions with assets of US$ 7.1 billion (June 2004).

A key aspect of the BMA regulation is that the Agency implements a parallel regulatory system where Islamic and conventional banks are separately licensed.

The BMA was the first central bank to develop and issue comprehensive prudential regulations for Islamic banks (PIRI), introduced in 2002.

The BMA has implemented the AAOIFI accounting standards as a benchmark for all Islamic Financial Institutions.

Today, Bahrain’s Islamic financial institutions offer a diverse range of products, which include traditional Islamic structures such as Murabaha, Ijara, Mudaraba, Musharaka, Al-Salam and Istisna’a,
BMA’s CONTRIBUTION TO ISLAMIC CAPITAL MARKET

• The first sovereign to issue a Sukuk in the world, providing a new asset class to global financial community.

• The only sovereign, which has offered ten Sukuk Al Ijarah issues, with outstanding in excess of US 1.1 billion.

• BMA launched its debut international Sukuk Al Ijara successfully in June 2004.

• The latest offer (10th Issue) marks the longest tenor sukuk in the world with a maturity of 10 years.

• BMA’s medium and long term Ijara sukuk issuance program is complemented by a rolling program of a monthly issuance of short-term bonds, sukuk Al Salam.

• BMA is introducing the Islamic Repo, which will deepen the secondary Islamic capital market.
BMA IS TAKING PROACTIVE STEPS TO POSITION BAHRAIN AS THE REGIONAL SUKUK HUB

- The BMA has adopted a regular, well-communicated Islamic issuance calendar that is predominantly in US$:
  - Set a benchmark for local/regional corporates wishing to issue bonds in Bahrain
  - Develop awareness among corporates of bond financing
  - Attract international investors

- BMA is tapping the international sukuk market and working on sukuk structures that are based on international template and documentation – The motive is to place Bahrain on the global financial map.

- The BMA is in the process of defining primary dealer privileges and obligations and is in the process of appointing new primary dealers

- All issues will be listed on the Bahrain Stock Exchange to leverage its new efficient, scrip-less clearance and settlement infrastructure

- Alliance with a major credit rating agency is being pursued

Islamic Debt Capital Market
BMA - Role and Support to the Islamic Finance Industry

- IIFM
- Rating Agency (PIRI)
- Regulation (PIRI)
- IFSB
- General Council
- LMC
- Islamic Securities
- AAOIFI
- Training
Islamic Finance Support Institutions

- **Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)**
  - AAOIFI was registered in 1991 in Bahrain as an international autonomous non-profit making corporate body
  - Their mandate is to develop accounting, auditing governance and ethical thinking relating to the activities of Islamic financial institutions - in accordance with Islamic Sharia rules.

- **International Islamic Financial Market (IIFM)**
  - Bahrain has been chosen to host IIFM
  - Their mandate is to establish, develop and regulate an international financial market based on Sharia’a rules and principles

- **Liquidity Management Centre (LMC)**
  - LMC is also based in Bahrain
  - Their mandate is to assist Islamic financial institutions in managing their liquidity