

ISLAMIC FINANCE: DEVELOPMENT IN NON-TRADITIONAL MARKETS



The Islamic finance industry's geographical presence has grown beyond its traditional markets in the Middle East and South East Asia to include new players from diverse regions such as Africa, East Asia and the Americas. Given the bright prospects for the industry in these markets, it is likely that Islamic finance will continue to expand there.

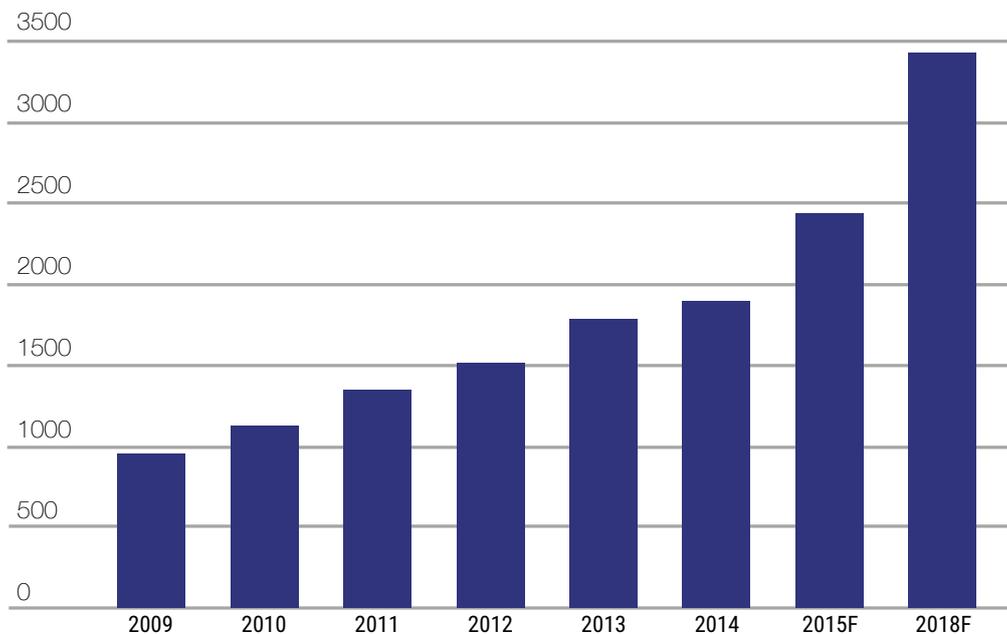
MALAYSIA
WORLD'S ISLAMIC FINANCE
MARKETPLACE

Islamic Finance: Development in Non-Traditional Markets

In just four decades, Islamic financial system has evolved into a comprehensive financial system of its own: ranging from banking, capital markets, to takaful

sectors.¹ To date, total global financial assets of the Islamic financial industry are estimated at USD2tn and are expected to surpass USD3tn by 2018.²

Total Islamic Finance Assets (2009-2018F)



Source: ISRA

The most significant players remain the Gulf Cooperation Council (GCC) countries and parts of South East Asia. In these countries, Islamic finance accounts for a sizeable and growing share of the domestic banking sector, catering to both large corporate clients and household financing.³

Islamic finance are emerging, with African countries launching debut sovereign sukuk and East Asian countries enabling their domestic markets to tap into Islamic finance.⁴ In addition, European banks in Russia and Germany are also investing in Islamic finance through debut sovereign sukuk and Islamic banking windows.⁵

Meanwhile, non-traditional markets for

¹ ISRA

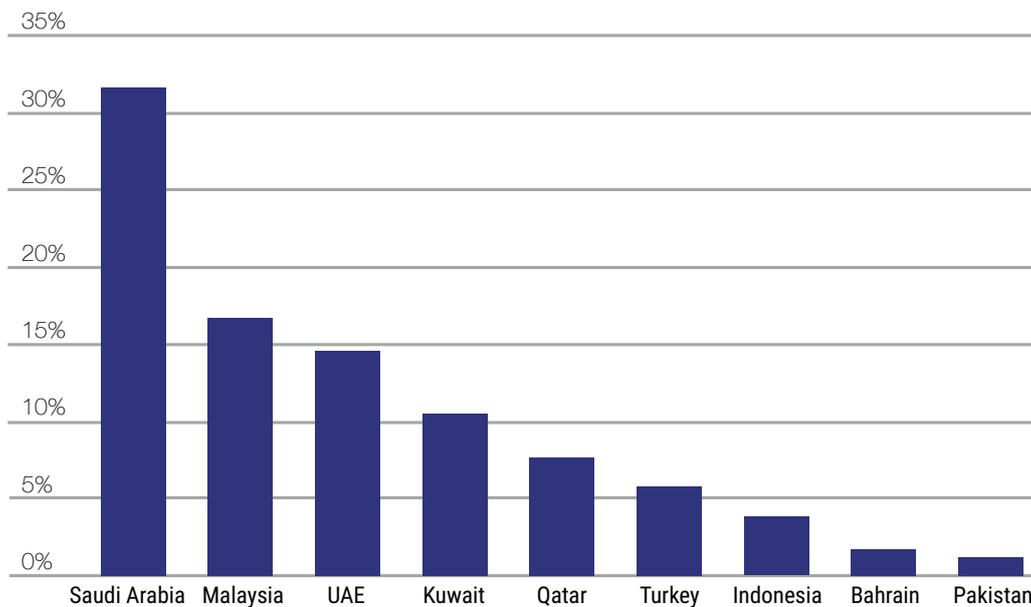
² ISRA estimates

³ MIFC

⁴ "New markets for Islamic finance emerging, study finds", Al Arabiya News (30th December 2015)

⁵ "New markets for Islamic finance emerging, study finds", Al Arabiya News (30th December 2015)

Total Islamic Finance Assets (2009-2018F)



Source: ISRA

Islamic Finance Offerings in Non-Traditional Markets

Presently, Islamic finance industry's geographical presence has grown beyond its traditional markets

Africa

The future growth prospects of Islamic finance in the African region are promising on the back of recent developments and initiatives in several new and niche Islamic finance markets.⁶ For instance, year 2014 witnessed the Islamic banking regulatory developments in African countries such as Uganda and Morocco, among other jurisdictions, each at a different stage of enacting its regulatory regime.⁷ In Uganda, its regulatory development include the approval of the amended Financial Institutions Act 2015, which paves way for the introduction of Islamic and Agency banking in the country.⁸ Moving to Morocco, through the Islamic banking regulatory

in the Middle East and South East Asia and includes new players from diverse regions such as Africa, East Asia, North and South America and others.

developments, Bank Al-Maghrib (Morocco Central Bank) is targeting to issue Islamic banking licenses by this year.⁹ Sharing similar sentiment, Qatar International Islamic Bank (QIIB) had recently signed an agreement with Moroccan lender Credit Immobilier et Hotelier S.A. (CIH Bank) to set up an Islamic bank in the country.¹⁰ The new Islamic bank, which will have QIIB taking up a 40 percent stake, is expected to launch in the coming months after necessary approvals.¹¹ Of more importance, to further substantiate the importance of Islamic finance in Morocco, the country has recently become a member of Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).¹²

⁶ IFSB Islamic Financial Services Industry Stability Report 2015

⁷ IFSB Islamic Financial Services Industry Stability Report 2015

⁸ "Uganda legalises Islamic Banking", East African Business Week (June 21st 2015)

⁹ "Qatar International Islamic Bank, CIH to set up bank in Morocco", Reuters (24th December 2015)

¹⁰ "Qatar International Islamic Bank, CIH to set up bank in Morocco", Reuters (24th December 2015)

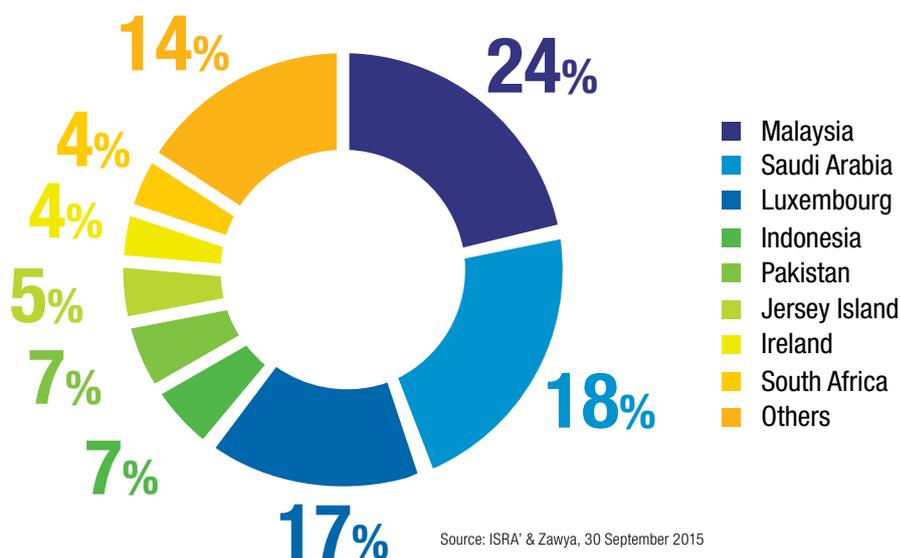
¹¹ "Qatar International Islamic Bank, CIH to set up bank in Morocco", Reuters (24th December 2015)

¹² "Islamic finance body AAOIFI to revamp standards, expand agenda", Reuters (7th December 2015)

On sukuk activities in Africa, the sector has now become an area of interest in various African countries such as Nigeria, South Africa, Senegal, Niger and Ivory Coast.¹³ Nigeria signalled the start of the trend through sukuk issuance of USD62mln with a yield of 14.75 percent in 2013.¹⁴ Following close behind, both South Africa and Senegal made their primary sovereign sukuk market debuts in 2014 at USD500mln and USD168mln issuances respectively.¹⁵ Ivory Coast has become the latest African state to issue a sovereign sukuk in November 2015.¹⁶ The country issued a five-year 150bln CFA priced at a profit rate of 5.75 percent. On the other hand, in 2015,¹⁷ Niger's government has established a sukuk programme worth 150bln CFA, permitting its first issue of sukuk, with assistance from the private sector arm of the Saudi-based Islamic Development Bank (IDB).¹⁸ This programme will be implemented during

2015-2020 for financing developmental projects.¹⁹ In addition, Kenya is among the jurisdictions deliberating on establishing Islamic capital markets, including sukuk.²⁰ Moving forward, Senegal is looking to issue a second sukuk through funding assistance from the Saudi-based IDB, whereby the sukuk issued is aimed to fund strategic infrastructure projects, such as regional express train linking Dakar to the new international airport Balise Daigne.²¹ As part of facilitating sukuk issuances in South Africa, the country's treasury has proposed extending the tax reforms to facilitate the issuances of sukuk by listed companies.²² The proposed change is expected to come into effect by early 2016.²³ Apart from sukuk activities, South Africa is currently the only African country with notable Islamic fund domiciles, contributing to 4 percent of the total number of Islamic funds in 2015.²⁴

Number of Islamic Funds by Country (3Q2015)



On Sudan, it has recently achieved significant milestone in Islamic finance. The country's leading Islamic financial institution Bank of Khartoum

(BOK) is presently in the process of establishing its first overseas branch office in the Kingdom of Bahrain.²⁵

¹³ "South Africa proposes extending sukuk to corporate issuers", Reuters (28th July 2015)
¹⁴ "Nigeria: Osun state issues country's first sukuk", The Economist (4th October 2013)
¹⁵ IFSB Islamic Financial Services Industry Stability Report 2015
¹⁶ "Ivory Coast launches Sovereign Sukuk", Islamicfinance.com (23rd November 2015)
¹⁷ "Ivory Coast launches Sovereign Sukuk", Islamicfinance.com (23rd November 2015)
¹⁸ "Niger to set up 150 bln CFA franc debut sukuk programme", Reuters (26th Feb 2015)
¹⁹ Database of Press Release related to Africa – APO-Source
²⁰ IFSB Islamic Financial Services Industry Stability Report 2015
²¹ "Senegal president asks Saudi-based IDB to help organize sukuk bond", Reuters (3rd April 2015)
²² "South Africa proposes extending sukuk to corporate issuers", Reuters (28th July 2015)
²³ "South Africa proposes extending sukuk to corporate issuers", Reuters (28th July 2015)
²⁴ ISRA and Zawya as at 30th September 2015
²⁵ "Top Sudanese lender opens Bahrain branch", Gulf Digital News (30th December 2015)

East Asia

In The East Asian powerhouses such as Japan, South Korea, Hong Kong and China have also shown interest in developing Islamic banking markets locally as well as to create opportunity for issuers to tap the sukuk market via their shores. To date, a number of Islamic banking related developments have taken place across East Asia, indicating strong growth prospects for this segment.²⁶ For instance, Japanese banking sector are taking steps to delve deeper into the arena of Islamic finance. One of the main steps taken is the announcement plans made in early 2015 by the financial regulator to relax the rules so as to create a conducive environment for the domestic banks to offer Islamic finance products.²⁷ To fully respond to this opportunity, Japan's largest bank, Bank of Tokyo-Mitsubishi alongside Sumitomo Mitsui Banking Corporation is considering handling Islamic finance services such as offering Shariah compliant financing and deposit products and services at their Dubai-based branch, subject to regulatory approval.²⁸ Japan International Cooperation Agency is also ramping up efforts to expand into Islamic finance—in particular working on a project with Jordan to help with plans to issue debut sukuk to meet growing demand within Muslim countries.²⁹ Moving to South Korea, as part of its effort to promote its interest in Islamic finance, the government has provided the necessary funding to the Islamic Financial Services Board (IFSB) latest initiative, the FIS E-learning Portal.³⁰ The FIS E-Learning Portal is in line with IFSB efforts to facilitate the implementation and assist in the

understanding of the IFSB Standards by member countries as through the portal it will help to increase the reachability of the IFSB's "Facilitating the Implementation of Standards (FIS)" initiative.³¹ Hong Kong has been working to become the centre for international financial intermediation between China and the Middle East as it is situated as the ideal gateway to channel the renminbi into the Islamic banking sector. Through its latest effort to promote Islamic finance in the city, the Hong Kong government has successfully issued its second sovereign sukuk in 2015, which is listed in the stock exchange of Hong Kong, Nasdaq Dubai and Bursa Malaysia.³² Buyers of the sukuk included 42 percent from the Middle East, 43 percent from Asia and 15 percent from Europe.³³ In addition, the financial hub had passed a tax bill in 2014 allowing the sales of sukuk and levelling the playing field between sukuk and conventional financing.³⁴ China's confidence on Islamic finance is evident through the recent issuance of its debut sukuk and is looking to apply Islamic finance for wide-ranging projects, from hospitals to metro stations.³⁵ Acknowledging that, both Qatar International Islamic Bank QSC and QNB Capital LLC has recently signed an agreement with China-based Southwest Securities to develop Shariah compliant finance products in the country.³⁶ In addition, Ningxia, an autonomous region in northwest China where a third of the 6.5 mln population are Muslim, is planning for USD1.5bln sukuk sale.³⁷

²⁶ Islamic Finance for Asia: Development, Prospects, and Inclusive Growth. *This publication is based on the presentations made during the ADB-IFSB on Islamic Finance for Asia: Development, Prospects and Inclusive Growth & Roundtable Session for Regulators.

²⁷ "Japan's Banks – Expanding Through Islamic Finance", International Banker (30th December 2015)

²⁸ "Japan looks for growth and influence from Islamic finance boom", Reuters (31st March 2015)

²⁹ "Japan's Banks – Expanding Through Islamic Finance", International Banker (30th December 2015)

³⁰ "The IFSB Introduces FIS E-Learning Portal to Facilitate Understanding of the IFSB Standards", Thomson Reuters Zawya, (8th December 2015)

³¹ "The IFSB Introduces FIS E-Learning Portal to Facilitate Understanding of the IFSB Standards", Thomson Reuters Zawya, (8th December 2015)

³² "Hong Kong government sells second Islamic sukuk bond to raise USD1.1 bln", South China Morning Post (28th May 2015)

³³ Hong Kong government sells second Islamic sukuk bond to raise USD1.1 bln", South China Morning Post (28th May 2015)

³⁴ <http://www.asiabriefing.com/news/2014/07/asia-future-islamic-finance/>

³⁵ "China Readies for Islamic Finance With a Little Help from Gulf", Bloomberg Business (20th April 2015)

³⁶ "China readies for Islamic finance, with helping hands from Gulf", Business Day (20th April 2015)

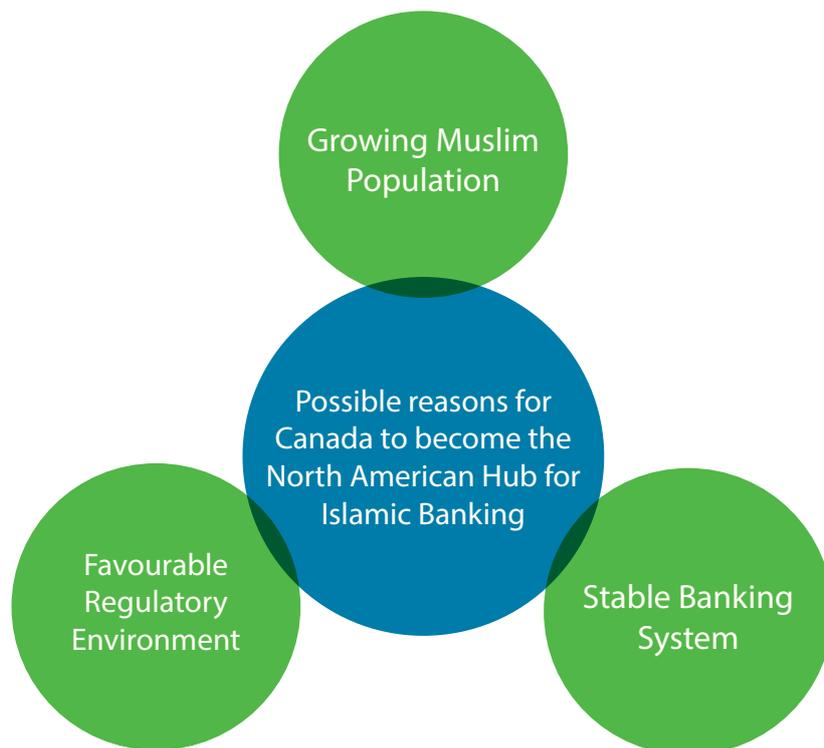
³⁷ "China Readies for Islamic Finance With a Little Help from Gulf", Bloomberg Business (20th April 2015)

North and South America

In the North American region, Islamic finance is being touted as the next big thing for Canada’s financial services sector.³⁸ Of more importance, Canada has various advantages which might linked it to the potential success of Islamic finance in the country - including a growing Muslim population, a stable banking system and a favourable regulatory environment.³⁹ Through these strings of advantages, this may enable Canada to position itself as the North American hub for Islamic banking.⁴⁰ Evident

to this statement, both Thomson Reuters and the Toronto Financial Services Alliance (TFSA) has recently unveiled a major study titled “The Canada Islamic Finance Outlook 2016 Report”.⁴¹ The report provides a comprehensive analysis and assessment of the current state and potential opportunities in Canada going forward, and aims to become the global reference point for information, analysis and insights on Islamic finance opportunities in Canada.⁴²

Possible Reasons for Canada to become the North American Hub for Islamic Banking



Source: ISRA' & Zawya, 30 September 2015

At the same time, in the United States of America (US), both the economy and financial markets propose ample opportunities for Islamic finance to take root in the country. The financial markets in the

US are the largest and most liquid in the world.⁴³ As of 3Q 2015, US contributed to 5 percent of the market share of the global Islamic AuM.

³⁸ "Canada poised to be hub of Islamic finance", CBCnews (23rd December 2015)

³⁹ "Canada poised to be hub of Islamic finance", CBCnews (23rd December 2015)

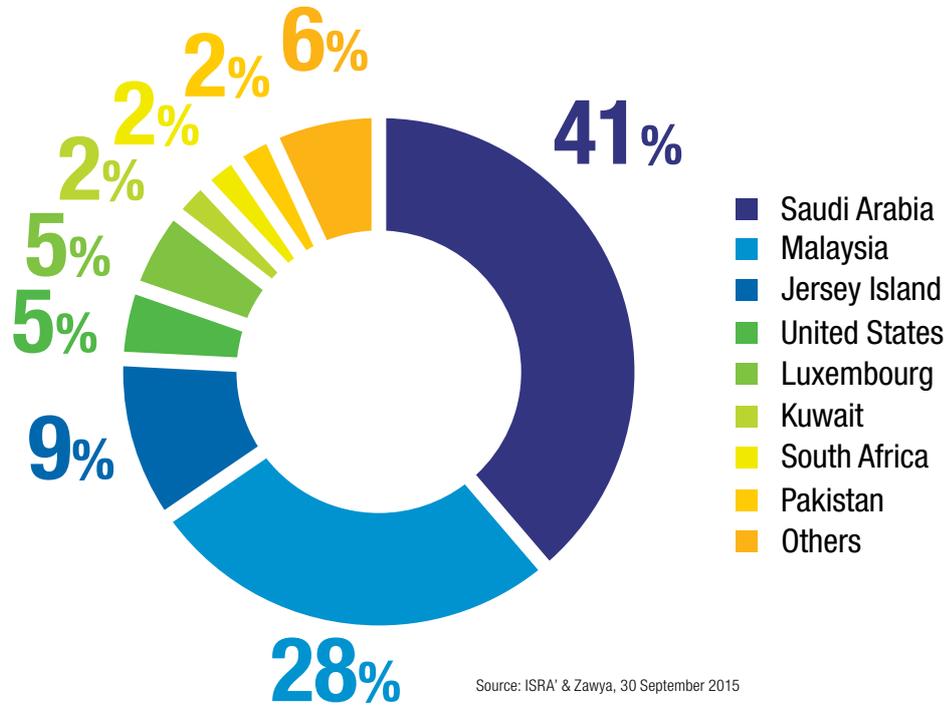
⁴⁰ "Canada poised to be hub of Islamic finance", CBCnews (23rd December 2015)

⁴¹ "Canada poised to become regional hub for Islamic finance", Albawaba Business (6th December 2015)

⁴² "Canada poised to become regional hub for Islamic finance", Albawaba Business (6th December 2015)

⁴³ Select USA

Global Islamic Assets under Management (AuM) by domicile (USD billion) (3Q 2015)



On the sukuk front, as of end-2014, there have been two issuances namely from Goldman Sachs, a leading conventional investment bank and the

International Finance Facility for Immunisation (IFFIM). Both issued USD500mIn sukuk each.

Selected Sukuk Issuances as at end-2014

Selected Sukuk Issuances as at end-2014		
Issuer	Goldman Sachs	International Finance
Date	September 2014	November 2014
Amount	USD 500mIn	USD 500mIn
Sector	Financial Services	Financial Services
Structure	Wakalah	Murahabah
Tenor	5 Years	3 Years

Source: Zawya, ISRA

In the South American region, Brazil's Islamic finance potential is often associated with its robust Halal food industry (world's largest halal meat producer); however infrastructure is another potential investment area for Islamic finance in Brazil especially in light of the government's attempt to capture foreign capital into the segment.⁴⁴ In the past few years, Brazil has undertaken robust infrastructure projects, especially in the area of housing, sanitation, transportation and energy, as part of its 2007 Growth Acceleration Programme.⁴⁵ However, a significant portion of those investments are presently in need of further financing to move forward – which therefore creates the opportunity for Islamic finance to step in.⁴⁶ Recognising such potential, Brazilian property

Other Potential Markets

Apart from the new frontiers highlighted above, other countries such as Russia and Germany are also showing keen interests in Islamic finance. For instance, last year, the lower house of the Federal Assembly of Russia, the State Duma is reviewing the existing laws on financial rent and leasing so as to remove any obstacles to the commission of Ijarah transactions.⁵⁰ Meanwhile in Germany, the country

Advantages of Islamic Finance Offerings in Non-Traditional Markets

Being new players in the industry come with various advantages. They can learn from the experiences of other more established Islamic finance centres. Therefore these non-traditional markets have the opportunity to jump start into 30 years of modern Islamic finance practices. They could move fast, avoid expensive pitfalls and adopt best practices. With the availability of established global best practices and standards, non-traditional markets need not go to the trial and error period of the more established centres. Therefore these new

developer Ritz Property and construction company G5, through its partnership (Ritz-G5), in February 2015 announced a Shariah compliant investment avenue in its Natal-based premium residential project, Majestic Village.⁴⁷ The Brazilian premium residential project is the first independent investment product to be eligible for Shariah compliant funding.⁴⁸ The project is designed to appeal to the domestic market and Brazil's rising middle and upper class population of over 90 million.⁴⁹ Overall, even though there is no specific legal framework in place for Islamic finance in Brazil, the government supports the use of Islamic finance contracts such as Salam, Murabahah and Mudharabah to structure financial instruments that are widely used in Brazilian agribusiness.

has opened its first Islamic bank in Frankfurt in 2015.⁵¹ The Frankfurt-based bank, called KT Bank AG, is owned by Kuveyt Turk, the largest Islamic banking institution in Turkey.⁵² KT Bank plans to reach Cologne, Hamburg and Munich in the near future.⁵³ Further reiterating its interest in Islamic finance, the country is urging for more Islamic finance integration globally.⁵⁴

entrants can avoid costly mistakes. Instead global best practices and standards can be adopted and adapted to local circumstances. In addition, there are already proven practices and documentations that have been established through many years of efforts by the accountants, lawyers, tax experts, regulators and bankers who have put their minds to create standardised agreements and instruments, that are now widely accepted across jurisdictions. These agreements and instruments have stood the test of market and time, therefore it is wise to adapt and customise them to the respective local environment.

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⁵⁰ "Russia Progressing on Islamic Finance Legal Framework", Islamicfinance.com (27th November 2015)

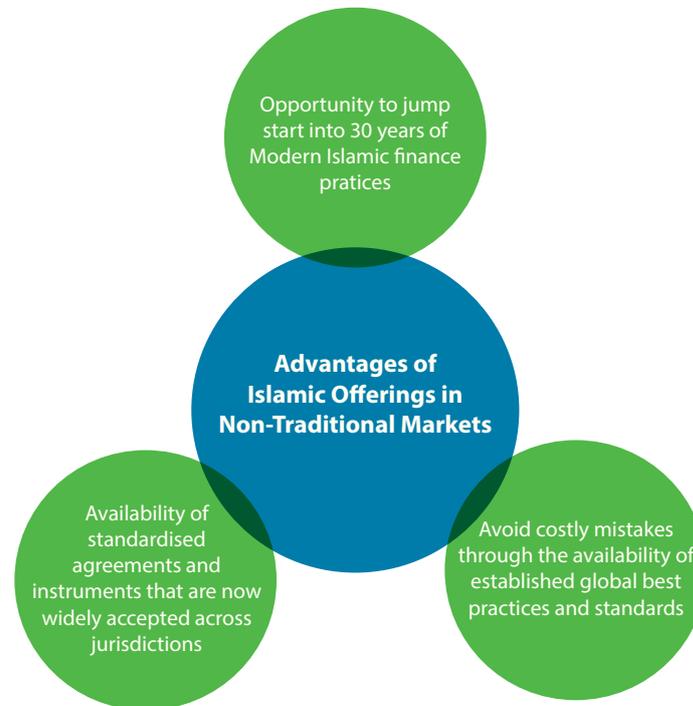
⁵¹ "Germany's first interest-free Islamic bank opens in Frankfurt", RT (1st July 2015)

⁵² "Germany's first interest-free Islamic bank opens in Frankfurt", RT (1st July 2015)

⁵³ "Germany's first interest-free Islamic bank opens in Frankfurt", RT (1st July 2015)

⁵⁴ G20-Germany urges more Islamic finance integration globally, Reuters (5th September 2015)

Advantages of Islamic Offerings in Non-Traditional markets



Source: ISRA

Conclusion

Overall the rapid development of Islamic finance in non-traditional markets has proven the practicality of Islamic finance solutions. Given the value proposition of Islamic finance, it offers a unique alternative service to these non-traditional markets. Of more importance, through the presence of Islamic finance, these will create enhancements of trade and financial linkages between these non-

traditional markets and the various OIC countries where Islamic finance has deep presence. In conclusion, given the bright prospects for Islamic finance in these non-traditional markets along with the various advantages highlighted above for being the new players of the industry, it is likely that the industry will continue to expand in these non-traditional markets.

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