ISSUE NO. 165
JULY–SEPTEMBER 2007
RAJAB–RAMADAN 1428

PUBLISHED SINCE 1991

NEWHORIZON

GLOBAL PERSPECTIVE ON ISLAMIC BANKING & INSURANCE

MALAYSIA: LEADING THE WAY

POINT OF VIEW: STRUCTURED DERIVATIVES IN ISLAMIC FINANCE

IIBI RECEIVES ODL QC ACCREDITATION

FAIR FINANCE: INCLUSIVE BANKING

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INSTITUTE OF ISLAMIC BANKING AND INSURANCE

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Deal not unjustly, and ye shall not be dealt with unjustly.

Surat Al Baqara, Holy Quran

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ISSN 0955-095X

Executive Editor's Note

This third issue of NewHorizon in 2007, which comes out in Ramadan – the Holy Month for Muslims, marks a number of positive developments in Shari'ah-compliant finance around the globe, as well as – no less important – developments within the Institute itself. You may have noticed the new look of the IIBI's logo on the cover of the magazine. This encompasses a fresh take on the traditional crescent-shaped logo that has been an integral part of the Institute's brand for the last 16 years. The combination of three crescents in the new logo represents the key objectives of the Institute: education, promotion and the implementation of Islamic finance in all its forms.

Also, the IIBI has received accreditation from the UK guardian of quality in open and distance learning, ODL QC, which marks a major step forward in this type of Islamic finance education. The Institute is currently developing a new range of courses (in both Islamic banking and insurance) aimed at the widest scope of takers around the world.

As part of the IIBI's global reach strategy, NewHorizon now becomes available online, with regularly updated news and recruitment sections, a calendar of upcoming events and, of course, complete contents of the current and previous issues of the magazine.

This issue of NewHorizon brings you, amongst other things, a comprehensive analysis of Islamic finance in Malaysia; an assessment of the Islamic banking market in Pakistan through the eyes of its newest player, First Dawood Islamic Bank; and a review of a controversial debate on how structured derivatives can fit into Shari'ah-compliant finance. And there is much more to read and reflect upon within the pages of the magazine. We hope that NewHorizon will help you to do exactly what the IIBI's slogan states – to discover new perspectives.

Mohammad Ali Qayyum
Director General, IIBI

Pak-Qatar receives first family takaful licence in Pakistan

The Pak-Qatar group has become the first company to receive a family takaful licence from the Securities and Exchange Commission of Pakistan (SECP). This now makes it the first company to have both family and general takaful under one umbrella in the country.

The group has set up two separate companies: Pak-Qatar Family Takaful and Pak-Qatar General Takaful. These companies differ in the types of products they will offer. The general takaful company will offer products covering property, auto, marine, engineering and other areas, whereas the family takaful company will offer financial protection for families in the case of death or disability to the breadwinner, health benefits, education plans, retirement income plans and other savings schemes.

The group's backing comes from Qatari investors. It has backing from Qatar Islamic Insurance Company, Qatar Islamic Bank, Qatar International Islamic Bank, Qatar National Bank and the Amwal Group. The SECP granted both companies their licences on 16th August. Family Takaful has a paid-up capital of $8.26 million (Rs500 million) and General Takaful has a paid-up capital of $4.95 million (Rs300 million).

Global sukuk market hits new high

The first half of 2007 has seen the global sukuk market hit a new high with market value totalling $24.5 billion, 75 per cent growth from the same period last year. This figure comes from IFIS Analysts' Sukuk Market Report First Half 2007.

The report covers the period January to June 2007, and shows that the international sukuk market has grown by 83.3 per cent over the past year. Also in the report was a league table of sukuk book runners. CIMB Islamic topped the overall table, having issued $3.15 billion in domestic and international bonds. It also topped the domestic table with a total of $2.87 billion issued in Malaysia.

The largest international book runner was Deutsche Bank, aggregating $952 million in sukuk issuance.

First Islamic bank launched in Kyrgyzstan

EcoBank, the first bank in Kyrgyzstan to open an Islamic window, has been officially launched. The bank was a recipient of funding from the Islamic Corporation for the Development of the Private Sector (ICD) which was represented at the launch by CEO Dr Ali Soliman. Also present was the nation's president H.E. Kurmanbek Bakiev and H.E. Dr Ahmed M Ali, president of the Islamic Development Bank (IDB) group. Representatives of the ICD and IDB were in the country for a series of meetings to discuss the direction of Islamic finance following a technical assistance grant from the IDB. There have been recent legal changes in Kyrgyzstan to try to make it a regional leader in Islamic finance. Under these law changes double taxation on Islamic leasing operations has been abolished and income taxes on corporate and personal income have been reduced.
In the last issue (April–June 2007), NewHorizon extensively reported on the development of Islamic banking in this predominantly Muslim CIS country.


Kyrgyzstan

IFSB calls for takaful regulation

The Islamic Financial Services Board (IFSB) believes that the absence of a clear regulatory framework is hindering the growth of the takaful industry. The standard-setting organisation believes that the growth of the sector is stunted by a lack of legal and regulatory certainty, and resultant inadequacies in risk management. It is calling for a dialogue within the industry to adapt current insurance regulations to meet the specificities of Islamic finance.

Extreme riba comes under attack in US

The Muslim American Society (MAS) has linked up with members of the Washington, DC interfaith community in a protest against so-called payday consumer loans.

Supporters of the MAS Freedom Foundation and the interfaith community joined in a July demonstration, centred on a capital city-based loan shop, protesting against the $28 billion a year industry which they criticise for unfairly targeting poor and minority communities with loans subject to interest rates often in excess of 400 per cent.

A counter-demonstration was mounted by a number of loan shop employees who waved placards proclaiming their 'love' for their loan customers.

MAS's Ibrahim Ramey was not impressed. 'They love their customers in the same way that liquor stores love alcoholics,' he says. 'These people prey on poor and financially desperate people, and participate in the economic exploitation of communities.' The practice of making payday loans has also attracted the attention and anger of consumer advocates throughout the US. They are supporting legislation at local, state, and federal levels to regulate the industry.

The loans, typically offered to low-income people with little or no access to established financial institutions, can mean instant credit for several hundred to several thousand dollars. The borrower hands over post-dated cheques to the lender, usually timed to coincide with the receipt of a pay cheque.

Apart from the ultra-high interest rates, problems often start when borrowers cannot meet the full repayment of their loan, forcing them either to extend it for a fee or add to it – techniques known in the industry as roll-over and loan flipping.

Each loan extension compounds the interest accrued on the loan. This, he adds, makes the original amount of money borrowed 'almost impossible to re-pay'.

A November 2006 report by the US-based Center for

Responsible Lending finds that 90 per cent of payday lending revenues are based on fees stripped from trapped borrowers, with 91 per cent of payday loans going to borrowers with five or more loan transactions per year. This figure is virtually unchanged from its 2003 findings.

The report also notes that the typical payday borrower pays back $793 for a $325 loan. The Center concludes that 'predatory payday lending now costs American families $4.2 billion per year in excessive fees'.

Mahdi Bray *(above),* MAS Freedom Foundation's executive director, is calling for payday loan operations to be shut down. 'This form of lending cannot be justified in any form of scripture in Judaism, Christianity, or Islam,' he says. He adds that 'as Muslims, we know that our Holy Quran prohibits usury in commerce'. With payday loans seemingly representing the most extreme form of this practice, MAS 'completely supports the consumer advocates who demand an end to this form of financial exploitation'.

MAS has drawn support from the first elected Muslim representative in Congress, Keith Ellison. He is co-sponsoring an act of federal legislation, known as the Pay Day Loan Reform Act of 2007, which has already been presented to the House of Representatives. Similar legislation, which would severely limit the interest rates applied to these loans, is currently before the Washington, DC City Council.

In the UK, Faisel Rahman's Fair Finance organisation is seeking to counter similar lending practices (see p10 in this issue).

Albaraka eyes Syria and Asia

Bahrain-based Albaraka Banking Group has been licensed to establish a new subsidiary in Syria.

The Islamic banking giant has targeted the country because of the economic and trade relationships it has with the rest of the world.

The subsidiary, to be called Albaraka Bank Syria, will provide Islamic banking products and services to individuals and companies.

A branch network has been planned to cover the main cities in the country.

The bank will start its operations by the end of this year with an authorised capital of $100 million.

The Bahraini banking group is planning further expansion into new countries. Asia seems to be the next target, with a reported $300 million to be invested in operations in India, China, Indonesia, and Malaysia over the next four years.

NCB in largest ever Islamic banking M&A transaction

The largest ever M&A (Mergers and Acquisitions) transaction in Islamic banking is set to see another foreign investor enter the Turkish banking industry. Saudi Arabia's National Commercial Bank (NCB), the largest bank by assets in the Kingdom, is attempting to buy a 60 per cent equity stake in Türkiye Finans Katilim Bankasi.

Türkiye Finans is a participation bank. These are Shari'ah-compliant banks that do not charge or pay interest on loans or deposits, but instead offer customers participation in their profits. The bank was formed as the result of a merger between Anadolu Finans and Family Finans in 2005. The bank is jointly owned by Boydak Group and Ülker Group; at the end of the last financial year it had a 125-branch network, and assets of $3.2 billion. Under the terms of the deal NCB, which is being advised by White and Case, would pay around $1.08 billion for its 60 per cent stake in the bank. The remaining 40 per cent of the company would be equally split between Boydak and Ülker. The deal is subject to regulatory approval, and is expected to close by the end of the first quarter of 2008.

Islamic systems fly off the shelf in the Middle East

Software suppliers are seeing increased popularity for their Islamic banking offerings in the Middle East. Some of the biggest vendors have recently had wins for their systems at a variety of Islamic financial institutions in the region.

Meezan Bank has decided to take the T24 Islamic model bank from Swiss vendor Temenos. Set up five years ago, Meezan Bank is a purely Islamic bank with over 60 branches in Pakistan.

According to Temenos' general manager for the Middle East, Juan Cerudo, with 'large expansion plans' to increase its presence to 250 branches in the next five years, the bank 'felt an international banking system would help them take their plans forward'.

Another Pakistani bank with similar ambitious growth strategy, Bankislami, has also been busy with its systems selection. On the core back office side it has opted for iMAL from Kuwait-based Path to be deployed across the bank's 19-branch network. The other selected system is the XM3 anti-money laundering solution from US vendor Haydrian. The win came out of the vendor's Karachi office, and is its first in Pakistan.

Albaraka Banking Group (ABG) has selected UK-based Misys' Equation for three sites: Bahrain, Beirut, and Durban in South Africa. ABG is made up of ten banks in different geographies around the world, and is one of the largest Islamic banking groups in existence.

Equation will be implemented first in Bahrain in the course of twelve months. The South African site is most likely to be the next on the list. The installations are set to take less time in each instance; the second is scheduled for ten months with this reduced to nine for the final project.

Aston Martin deal wins Islamic finance award

The Investment Dar has won the award for 'most innovative financing transaction' for its acquisition of the Aston Martin Car Company at the inaugural Islamic Finance Awards. The transaction, completed in mid-June, was worth £479 million ($965 million). The deal was made up of 60 per cent financed through equity contributions with the rest funded through a murabaha facility arranged by the London branch of WestLB.

Also recognised at the awards was Dr Zeti Akhtar Aziz, governor of Bank Negara Malaysia (central bank), for 'outstanding contribution to the development of an Islamic capital market' for her role in establishing Malaysia as the most developed Islamic capital market in the world.

Lord Eddie George (interviewed in New Horizon, April-June 2007), former governor of the Bank of England (central bank), also won an award for 'outstanding contribution to the development of Islamic finance in the UK'.

Aston Martin

Kuwaiti banks target UK for new Islamic subsidiaries

Two Kuwaiti banks are trying to set up subsidiaries in the UK. Boubyan Bank and Securities House have both targeted the country as a location for new Islamic financial institutions.

Boubyan Bank has entered the UK market with a 20 per cent stake in Bank of London and the Middle East (BLME). The new institution recently received authorisation from the Financial Services Authority (FSA) to launch as a standalone, wholesale, Shari'ah-compliant bank.

The bank, which is based in London, will focus on four main business lines. These are Islamic treasury and financial institutions; corporate banking; private banking and investment management; and investment banking.

BLME has raised $347 million (£175 million) from its institutional shareholders. The remaining 80 per cent not owned by the Kuwaiti bank is held by a combination of financial institutions, investment companies and employees. Humphrey Percy has been appointed as CEO of the new bank.

Also trying to enter the UK is Securities House. The company has set up a wholly-owned public limited company in the UK and applied for a licence from the FSA. The licence it has applied for would allow it to act as a deposit-taking banking entity within the UK. Securities House says that the new company will be established in London as a Shari'ah-compliant wholesale investment bank. It will focus on Islamic capital markets, Islamic treasury business and asset management. The new company will have a paid-up capital of $396 million (£200 million) and David Testa has been appointed as its CEO.

The UK is trying to establish itself as a hub for Islamic finance and two new Islamic banks goes some way to consolidating this position. The UK government has the set aims of entrenching London's position as a global gateway for Islamic finance with sukuk seeming to be the main point on its agenda.

The UK's plans for the trading of sukuk were set out by then economic secretary Ed Balls at The London Islamic Financial Services Summit in January (NewHorizon, January–March 2007). These have been backed up by his successor Kitty Ussher at the first meeting of the UK's Islamic Finance Experts Group.

At the meeting, the group discussed the feasibility of the UK government issuing the first sterling sovereign sukuk, with the discussion focusing on the potential benefits of issuing a sukuk. The group also talked about recent market developments, and how the business and Islamic comm-unities could work together to drive Islamic finance forward in the UK.

Bahraini developments select Sakana as preferred Islamic mortgage provider

It has been a busy time for Shari'ah-compliant mortgage provider Sakana Holistic Housing Solutions. The Bahrain-based financial institution has signed agreements making it the preferred Islamic mortgage provider for two developments in the Kingdom. It has also become the first lender in Bahrain to offer mortgage finance for more than one million Bahraini Dinars.

The first deal is with Bahraini property developer Al Saraya. The intention is to allow more buyers to enter the market by taking advantage of a mortgage which is in line with their faith. Under the terms of the agreement, Sakana will provide finance approval for potential buyers interested in Al Saraya properties such as the recently completed Al Marsa floating city in the Amwaj Islands.

The deal was signed by Sakana CEO R Lakshmanan *(below right)* and Al Saraya general manager Yasser Al Sharrah *(below left)*.

This deal follows on from an earlier memorandum of understanding signed with another domestic property developer, Durrat Al Bahrain. It sees Sakana become the preferred Islamic mortgage provider for the largest luxury residential, commercial and resort development in the Kingdom.

These are the latest in a string of partnerships that Sakana has entered into across the Kingdom. According to Lakshmanan, the reason for signing agreements like these is to 'facilitate the home buying process'.

The Islamic lender has also extended its line of mortgage credit to $3.32 million (BD1.25 million). This is the first time a mortgage of this value has been available to the public in the Kingdom. Prior to this offering, to receive a line of credit of this value people would have to apply for a commercial loan. The mortgage can be taken out for one property, or split over a number of investments. There will be a period of three months for the borrower to decide how to allocate the funds which can be used to finance residential, commercial and investment properties. Sakana is jointly owned by two of Bahrain's leading banks, Bank of Bahrain and Kuwait and Shamil Bank.

The loan shark hunter

For UK loans firm, Fair Finance, losing a customer to the mainstream financial markets is a sign of success. As a link between the financially excluded and the financially included, it offers fair and equitable access to credit as well as advice and support which, although interest-based, bears close resemblance to some of the principles supporting Islamic finance. There may be some lessons to be learnt by Islamic banks. Tom Alford, NewHorizon's contributing editor, talks to CEO, Faisel Rahman.

No one could accuse Fair Finance boss, Faisel Rahman, of not doing his homework before setting up the business. Having spent five months as an intern with Nobel Peace Prize winner, Muhammad Yunus' Grameen Bank – an organisation devoted to banking the unbanked in Bangladesh – he moved on to research microfinance for a year at the World Bank.

And following a stint as a trainee underwriter at Lloyds of London, Rahman, the son of Bengali immigrants to London, is now putting to good use his worldly experience and solid belief that finance should be inclusive not exclusive. Fair Finance was launched in April 2005 using the £5000 ($10,000) limit on Rahman's personal credit card.

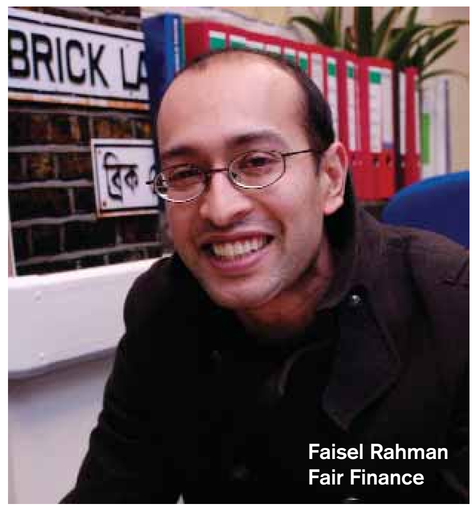
His aim was, and still is, to deliver 'a single, holistic organisation that could provide a range of financial services to financially excluded individuals' who are generally the poor and unbanked segment of society. This translates into solid debt advice and a safer financial alternative to the loan sharks that prey upon some of the UK's poorest communities, primarily in London's east-end boroughs which have a large Muslim population: Rahman's first office was located in the heart of a council-run housing estate in Stepney in the London Borough of Tower Hamlets.

To meet increasing demand, a second office has opened in the London Borough of Hackney. The catchment area also takes in the boroughs of Newham, Waltham Forest and Haringey, together making up a culturally diverse community of about 1.5 million people. It's a naturally vibrant community but also represents a melting pot of one of the UK's highest concentrations of the financially dispossessed, right on the doorstep of the world's financial capital.

With such an obvious disparity, Rahman was motivated from the outset by 'the challenge of injustice'. From this standpoint his challenge to society is to seek an answer as to why the poor pay more for services that the rest of us take for granted and to address the issue of why they are excluded from enjoying the benefits of a growing economy.

With Fair Finance, he is not just asking the questions, he is taking positive action. And through Fair Finance he is throwing down the gauntlet to mainstream financial-providers to think about what they are doing to an increasing mass of people. Underscoring his point, Rahman amusingly misappropriates NatWest Bank's advertising tagline which states that 'there is another way'. Indeed there is according to Rahman – and it doesn't involve using the services of NatWest.

Islamic finance, with its primary goal of social justice and the eradication of interest, is still seen by many as an option mainly for the rich and not for the often neglected and disadvantaged poor. Microfinance, though based on charging interest to poor clients, has demonstrated successes as a finance tool in helping to attract the unbanked poor and in encouraging them to seek their economic upliftment. Both Islamic finance and microfinance share the noble goal of a society free from economic elevation.



Faisel Rahman
Fair Finance

Fair Finance is a small, not-for-profit operation, but it is growing. When it first opened its doors for business, it employed two debt advisors, two loan officers, an administrator and Rahman himself. The team has now been boosted to twelve, three of whom are lenders, with the remainder debt advisors.

While Fair Finance operates on conventional interest-based principles, its commitment is very much to responsible lending. Rahman estimates Fair Finance has saved his customers almost the same total as the firm's first year total book-value in excessive payments to less scrupulous lenders. Some of these will charge more than 1000 (yes, one thousand) per cent APR to the people least able to afford it. As a mark of what this represents, in its first year of trading, 1000 people approached for a loan, of whom more than 300 were accepted for loans, worth around £500,000 ($1 million). This year, the loan book has reached 500 from over 2000 applicants. The word is spreading amongst this sprawling confluence of the unbanked and unbankable.

Perhaps most prevalent in the sort of communities in which Fair Finance operates are the so-called door-step lenders. Agents of these firms literally knock on doors offering small personal consumption loans – perhaps a few hundred pounds – often for basic commodities such as fridges and cookers. This industry serves over two million people in the UK alone, subjecting customers to starting interest rates of more than 400 per cent; this can be discounted to around 200 per cent if the customer proves to be a good payer. 'What we wanted to do was develop a method that would allow us to get to those people and offer them an alternative,' says Rahman. With his Grameen Bank microfinance training, he also saw that there was potential to help a growing army of skilled individuals ready but not able to start their own businesses. 'We wanted to lend to people who had recently been bankrupted but wanted to start a business, and to people who had never been in the financial system but wanted to start a business,' he says. The latter group includes recent immigrants to the UK who, through no fault of their own, simply don't have any credit history and are unable to access mainstream funding to grow their ideas.

Fair Finance loans to consumers typically start at around £600 ($1200) over 14 months, with business loans extending to around £2000 ($4000) over 30 months. Interest rates reflect the higher risk and are higher than current UK credit card levels. But they are nowhere near the loan shark numbers. As a not-for-profit organisation it does not have to serve shareholders demanding high returns on their capital investments. And with the largest personal loan rising to just £2000 ($4000), Rahman states that Fair Finance is leaving its market focused on the 'very poor'.

The company has two distinct borrower types that serve to highlight an interesting dichotomy in the financial market. On the one side, there is financial exclusion, and on the other, financial exploitation. For the latter group, who often have too much credit, Rahman saw a desperate need for debt advice to ensure that these people had a way of managing their finances, finding a way to stick to their payment plans and to deal with the practical and emotional fall-out from consumer debt. 'In a way, what we are trying to do is what the banking industry did about 15 or 20 years ago,' he says. 'And that is to actually talk to clients.

'Our priority is about making responsible loans, which I don't think is happening that much,' he notes, pointing out that there is often an ill-judged separation between collection and lending operations within some of the high-pressure loans companies. Forming a financial pincer movement around the vulnerable – by incentivising one department to lend as much as possible and then incentivising a different department to collect as much as possible – does not create an environment conducive to sensible lending practice for the customer.

In a way, what we are trying to do is what the banking industry did about 15 or 20 years ago. And that is to actually talk to clients.

But there is a problem: the unbanked are seemingly subject to an infuriating banking Catch-22 which means an individual cannot get credit without a credit history. But how can an individual get a credit history without having credit?

One of the major problems for the financially excluded, therefore, is building up a credit history that can help them break free from the murky world of door-step lending. Even if someone does pay up regularly on a 400 per cent APR loan, they will still not be taken seriously by the mainstream, simply because they are not in the system.

Fair Finance sees itself as an intermediary in a position to create 'an appropriate credit history' for its customers on its own database. This data can filter through to the mainstream and help build a bridge between the two worlds.

This falls into line with Fair Finance's third strand of activity which sees it involved in social policy and campaigning. Rahman is keen to promote issues of over-indebtedness and exploitative lending. 'In a sense, our organisation is part delivery, part service,' he says. 'It's about offering a real, fair financial deal to people.'

He certainly has the ear of some of the most influential individuals and organisations in the UK financial industry. The company itself was officially declared open for business by Anna Bradley, the director of the FSA at the time, and Stephen Timms, chief secretary to the Treasury and MP for the local East Ham of London ward. The involvement of the wider financial community extends to the boardroom too, with members of the Royal Bank of Scotland (RBS) taking their place at the helm.

Rahman views the development of relationships with the traditional banking and finance world as a vital part of the plan. But he acknowledges that deeply held attitudes and beliefs will not change overnight. 'Getting them to be involved and see an alternative has always been the first stage,' he says. 'Getting them to change their practices is a much longer-term thing and I don't think we can see any real changes yet.'

Part of the problem of exclusion he attributes to the automation of many of the basic banking processes. This, he believes, has allowed banks to generate more profits in less time 'because they can spend less on training staff and use IT systems' instead. Automated links to credit bureaux, for example, whilst no doubt efficient, do not allow all the facts to be considered. Simply feeding personal data into a system and waiting for an automated loan decision does not favour individuals who do not exactly fit the banks' criteria. The three key criteria are employment, credit history and home ownership. Anyone falling outside of what is acceptable to the banks will be given a disproportionately high risk rating, whether the individual is a bad risk or not.

'By making the systems faster and more efficient, they have dropped a whole load of people outside the system,' Rahman says. 'Getting a bank to change that system is going to be very hard.'

Fair Finance is trying to show that it is possible to lend to people and develop an underwriting methodology that can be efficient as well as equitable: it's not simply about lending to them, it's about giving advice too. Cold, hard risk assessment technology is therefore not used by Fair Finance. It prefers the human touch.

Every potential customer will be offered an interview and part of this time will be taken up with an in-depth review of the individual's finances. This review considers everything including the financial minutiae such as how much is spent each week on cigarettes (if the applicant is a smoker) and entertainments. This process creates an accurate picture of what is affordable and whether the loan is even appropriate. Loan delinquency still happens, but Rahman believes his team can tell quite quickly whether a late payment is a matter of 'won't pay or can't pay', the latter being handled sympathetically. Actual bad debt levels in the first year ran at just over one per cent. Provision in the budget was for ten per cent. 'It is quite a risky market in many ways, because people are poor and things change rapidly,' Rahman says. 'The trick is to be flexible and ensure that the product you deliver is appropriate to their needs.'

Of course, there is a world of difference between processing a few thousand people a year and a few million, but Rahman nonetheless believes he can prove to the banks that the people they have forgotten are potentially people they should be lending to. The inclusion of enthusiastic RBS personnel on the Fair Finance board is partly about demonstrating what lending in the Fair Finance target community is like. But Rahman admits that, whilst it has a lot of high-level support in principle from the big banks, it has received very little practical commitment.

The big banks could hardly be more aware of the issue. The UK government's Treasury Select Committee frequently hounds them for excluding poor people. But, as Rahman notes, that positive response at the top is still taking time to be converted into positive action on the ground.

Some banks are making token gestures by offering the basic bank account concept to the unbanked. These are no frills affairs with practically no services offered, no interest payments, no advice and no credit-scoring payoff. It is questionable whether anyone would really want to place what little money they have into an account that did nothing for them. 'The banks will say they are trying to do something, but what they are delivering are products and services that are inappropriate to the needs of poor people,' complains Rahman with justification.

This is precisely the point where Fair Finance makes its entry as an intermediary: an organisation that can sit below the banks, but above the loan sharks, moneylenders, cheque-cashers and pawn shops.

Having moved on from the early days of supporting loans with his personal credit card, Rahman and Fair Finance now work directly with one of their few big-hitting supporters, RBS, which seemingly understands the principles behind an organisation lending to people that it would not normally entertain. But RBS also knows that once Fair Finance's customers have hauled themselves into the mainstream with a good credit rating, it has a ready-made client-base. 'It's the kind of partnership that we are trying to encourage with other banks,' says Rahman hopefully.

Fair Finance did have a working relationship with Barclays, but the UK's third largest bank has since moved on to other areas. All is not lost though, and the two businesses are back and talking to each other once more. Fair Finance also has the ear of a number of 'strategic banks' such as UBS and Citibank; the latter is trying to make a bigger UK consumer presence having bought the Egg credit card business.

In a move calculated to spread the good word, Rahman is seeking to offer Fair Finance's skills and knowledge of the sector to the banks to show them how they can deliver their services through his business. But he explains that it has been 'extremely hard' to engage other banks into this agenda. He cites some of the largest banks in the world as being 'completely disengaged' from the financial exclusion agenda, and from that of ensuring that finance can be provided for all those outside the system.

There is a potential market out there, as RBS has seen, and he is clearly disappointed that some financial institutions lack the foresight to reach out beyond their safe markets, perhaps for fear of damaging their quarterly results. Persuading banks to share a vision is one thing, but drumming up the capital to keep that vision going is quite another.

Fair Finance is registered as an industrial and provident society (IPS). This means that any investment is at risk and any one investor is capped at £20,000 ($40,000). This could restrict its investment appeal and growth potential. But aside from its own self-generated funds (it reinvests 100 per cent of its profits), Fair Finance has fairly solid backing. The list includes: social investors (who, in some cases, have put in up to that cap) as well as banks such as RBS which have lent money at preferential rates; sympathetic charitable investment funds that approve of the work being done; government funding made accessible because Fair Finance is not only helping to create businesses through its microfinance programme, but also helping to manage debts through its advice programme; and a number of London housing associations that pay for advice dispensed to tenants.

It's a diverse range of capital, but it has not been easy to maintain the flow. 'When you are a small organisation like ours, it is very hard to find the capacity-building resources to grow the infrastructure of the organisation itself, to be big enough to be sustainable,' notes Rahman. The VC community, for example, is quite prepared to invest a lot of money quickly into a small number of agencies to make a systemic and sustainable change. But in Fair Finance's sector, where the business model is less well understood, Rahman reports that investors only wish to drip-feed the funding over a longer period of time.

This makes it hard to reach the kind of scale that the business needs in order to be sustainable. Sticking resolutely to the remit of delivering services to customers not investors makes it even harder to raise the finance. The conscience of Fair Finance means that it has to be 'very tough' about making sure it gets finance that doesn't interfere with its job of delivering a service to the poor and excluded.

Naturally, Fair Finance is interested in encouraging more private and social investors. With a new form of tax relief being introduced that will give such investors a return, it may well drive that interest forward. 'We're hoping to use that to raise a substantial amount of money,' says Rahman.

The real challenge for him and his team though is to locate potential investors who aren't too risk-averse and who want to see their money doing good things in the community without looking for the kind ofreturns that the major retail or investment houses offer. The new tax relief on offer should bring some immediate measure of return for those that do venture this way. But Fair Finance is also placing great store in a new investment deal. Anyone investing for a five-year period will receive an annual dividend of 8.33 per cent of what they have put in, with the capital returned at the end of that time. It's still a risk, says Rahman, asking investors to believe in the business model.

There is no reason why all finance shouldn't be fair finance... It's about offering a real, fair financial deal to people.

This plan, he says, could become part of a portfolio offered by ethical investment IFAs, a number of whom he is in discussion with. The issue has also been raised with a number of banks as a proposition for their private wealth clients. Rahman claims 'quite substantial' interest to date.

Explaining the attraction of such an investment, he maintains that this is a movement that people are beginning to see more often. 'It's kind of in vogue to talk about social businesses that can make a return, especially with Muhammad Yunus recently winning the Nobel Peace Prize.'

It could put corporate and social responsibility beyond the PR department and into the mainstream of what investors want to do, he believes. 'Everybody wants to see how they can make their money work more than just simply making a return.'

The target for the first year of this new strand of investment is £1 million ($2 million). If it can achieve this and demonstrate that it is benefiting those who really need the money, he feels Fair Finance will be well placed to go back to the investors with a more ambitious plan. In the mid-term he can see the programme drawing up to £15 million ($30 million) of investment, allowing it to be rolled out across London and perhaps beyond. 'There is no reason why all finance shouldn't be fair finance,' he says, obviously aware of the marketing potential of such a statement. 'What we offer will not only compete with the sub-prime market but also show the mainstream market that there is a better way of delivering financial services – one that puts people before profits.'

Rahman believes that Fair Finance is very clearly an ethically rooted organisation with a not-for-profit structure that has a lot of resonance with the Islamic finance principles of justice and equality.

He believes that with the right type of ethically-minded investors in Islamic finance institutions, there is real potential to create an investment partnership to deliver a Shari'ah-compliant model through Fair Finance (in both its consumer and microfinance products) that is relevant and appropriate to the poor communities of London. As many of his existing clients are poor Muslims living in deprived neighbourhoods, the potential for working with more people excluded from the system is a compelling argument for those who want to use Islamic finance principles to make a difference in their lives.

While the straightforward moral and ethical arguments for using finance as a tool for inclusion and as a means to alleviate the financial problems of the poor are not always perceived as beneficial to financial institutions, with people like Rahman committed to the principles of a fairer financial system, it could ultimately help to create a more equitable society free from economic exploitation.

On the move

Bahrain-based BankMuscat International (BMI) has appointed a new CEO, Andrew Bainbridge *(left)*. He joins BMI from Barclays, with 18 years of experience working at Barclays' sites in the UK, Europe, Africa and the Middle East.

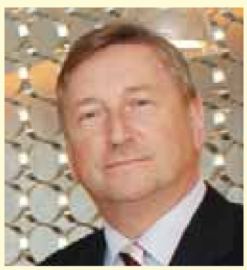
Sultan Choudhury has taken the role of commercial director at the Islamic Bank of Britain (IBB), the UK's first Shari'ah-compliant financial institution. He will be overseeing sales, marketing and operations functions of the bank.

International Islamic Financial Market (IIFM) has made a number of appointments. Khalid Hamad, executive director, banking supervision at the Central Bank of Bahrain, has been named new chairman and Mubarak El Tayeb El Amin, associate director, treasury at the Islamic Development Bank, has been appointed vice chairman.

Saleh Al Omair has been named CEO of a new takaful company currently being established in Saudi Arabia. The company will be a joint venture between domestic Ahad Insurance Company and Bahrain-based Solidarity, one of the world's largest takaful operators.

Mrs Ilke Toklu has been appointed general manager of Dubai-based Tejoori Limited, the world's first independent Islamic investment company to be listed on the Alternative Investment Market of the London Stock Exchange. Toklu made a major contribution to establishing and launching Tejoori.

Bahrain-based investment bank, Ithmaar Bank, has appointed Michael McKinlay as executive director, private equity. With over 25 years' experience in banking and investments (of which 15 years have been in the Middle East), McKinlay will 'add tremendously to the bank's pool of investment expertise', according to Michael P Lee, CEO of Ithmaar.



Volaw Trust & Corporate Services Limited, a fiduciary services provider based in Jersey, has appointed James Hume *(left)* as CEO of the company's new office in Dubai. Hume has extensive knowledge of Islamic finance and over 25 years' experience in private banking and trust services.

Tan Sri Abi Musa Asa'ari Mohamed Nor, former secretary-general of the Ministry of Agriculture and Agro-based Industry, Malaysia, has been appointed chairman of the Pilgrims Fund Board (Tabung Haji, TH). TH is a Malaysian corporation that provides financial services to Muslim pilgrims.

Abu Dhabi Islamic Bank has named Ragheed Najib al-Shanti as acting CEO and Khamis Buharoon as managing director of the bank. These appointments follow the resignation of Ahmed Darwish Al-Marar as managing director. Buharoon joins the bank from the UAE-based Commercial Bank International, while Shanti is already with Abu Dhabi Islamic – he has been on the bank's board.

AXA Insurance Gulf has named Paul Bromley as strategic development manager, responsible for the management of life business development in the Gulf Region. Bromley has 38 years' experience in finance, life assurance and family takaful, 12 of which he acquired working in the Middle East for Zurich Financial Services, Saudi British Bank and SALAMA.

Bank of London and the Middle East (BLME), an Islamic investment bank recently established in the UK, has named Humphrey Percy as CEO. Percy has over 30 years' experience in banking. Yacob Al-Muzaini, chairman and managing director of BLME's major shareholder, Kuwait-based Boubyan Bank, has been named chairman of BLME. Derek Weist has been appointed head of structured finance.

Bahrain-based investment bank Gulf Finance House (GFH) has appointed a new chairman, Esam Janahi, who has held the position of CEO since the bank's establishment. Janahi is one of the founders of GFH and currently also chairs Bahrain Financial Harbour, Energy City Qatar and Bayan Holding Company.

Bradley Brandon-Cross *(left)* has been appointed CEO of the British Islamic Insurance Company, which is currently awaiting licence from the UK's Financial Services Authority (FSA) to commence operations. Brandon-Cross is a co-founder of Rubicon, an insurance service provider in the UK.


Leadership is not achieved by coincidence . . . .
01
02
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EUROMONEY
2006 Islamic Finance Awards
POLICY
Islamic Finance Weekly Award 2004
Winner of Best Takaful Operator
Euromoney Islamic Finance Award 2006
Best Life Takaful Provider
Policy Magazine Award 2007
Life Insurer Of The Year (ME)
2004
BAJ
2006
BAJ
2007
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2008
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Structured derivatives in Islamic finance: keeping one step ahead of ibaha, or providing valuable protection?

The mention of 'structured derivatives' often arouses connotations of wild excesses of risk taking and of high volatility, whereas the actuality is that these products were originally developed to provide low-cost protection, or hedging, against unwanted market trends. To find out how these products can fit into Islamic finance, Don Brownlow, NewHorizon's contributing editor, spoke to Warren Edwardes, CEO of London-based Delphi Risk Management and member of the IIBI's informal Board of Governors.

Should the Islamic finance industry be scurrying around trying to replicate each and every complex derivative rather than focus on what is actually needed?

In the conventional banking world, banks are able to use an array of derivative products to manage risk – often to reduce risk, but sometimes to generate risk so that they can benefit from the increased returns that risk brings. Islamic financial institutions (IFI) also need to manage risk, not only in terms of the institutions' own treasury management but also to create products that allow their customers to do the same, for example, in order to reduce an individual's or corporation's exposure to currency risk.

Edwardes thinks that derivatives have gained a reputation for being dangerous gambling instruments following the debacles at Procter & Gamble, Bankers Trust and the widely publicised excesses of Nick Leeson at the defunct Baring Brothers. IFIs, in order to remain Shari'ah-compliant, must qualify their products and strategies through the scholars that provide supervisory authority.

There are various prohibitions in Islam regarding banking that must be abided by and in this regard the Shari'ah prohibits uncertainty (gharar) and gambling (qimar). As a result, many of the structures that have been created to provide the characteristics of conventional derivatives while still maintaining Shari'ah compliance are proprietary and are often not generally openly available. But, according to Edwardes, 'there is the concept of ibaha which means that if something is not banned then it is permitted'. Under this principle, he cautions that 'because something appears to be similar to something that is banned, then don't assume that it too is banned'. He points out that 'looking at some of the financial products on the market, it seems that everything is possible using murabaha. Who am I to disagree, bearing in mind the principle of ibaha?'

He points out that using 'murabaha an investor can "invest" in an "arm's length Special Purpose Vehicle" [a specially formed company] that in turn could create "trades" in anything – from options to futures to warrants'.

In any event, he argues that derivatives can be seen as permitted by saying 'murabaha and salam could be regarded as derivatives: one is buying or selling something with deferred payment [murabaha], the other is buying or selling something for deferred delivery [salam]. They are derivatives because one is buying/selling for future payment and the other is buying/selling for future delivery – forward payment or forward delivery. So derivatives are permitted because murabaha and salam are permitted'. These instruments can be regarded as 'forwards' in the conventional market. Forwards were one of the first derivative types to be developed for the conventional markets back in the mid-1980s.

Additionally, there are two other concepts that Edwardes believes are relevant – those of arboun and wakala. Arboun is a concept of down-payment for something; wakala is an agency agreement where an agent is paid a fee for performing a management function or a management service.

The IIBI defines arboun as a down-payment for the delivery of a specified quantity of a commodity on a pre-determined date. This can be regarded as having similar properties to that of an option in the conventional market. Edwardes comments that 'it is a down-payment that provides a right – similar to an option, but why use terms that are provocative?' Under wakala a management company may be paid a fee to provide 'dynamic delta hedging', for example, to manage foreign currency risk. (The 'delta' is a measure of volatility so, for example, if the market is as likely to go up as go down then the future is 50:50, or 50 per cent likelihood of movement so it has a delta of 0.5.)

In his book, 'Key Financial Instruments: understanding and innovating in the world of derivatives', Edwardes examines the concept that all banking products are built from four pillars: deposits, exchange, forwards and options. He thinks that, as almost anything is permitted in conventional banking, Islamic banking is no different, merely a special case. Just as conventional products can be built from the four pillars so too can Islamic products be built using Islamic equivalents. He suggests that 'to create Islamic derivatives without getting close to the edge, go back to first principles, to when derivatives were first created'.

Back in the 1970s, US and UK companies made back-to-back loans to hedge foreign currency exposures – a forerunner of currency swaps. 'Instead of using back-to-back loans, Islamic products can be created

Warren Edwardes
Delphi Risk Management

using Islamic equivalents of back-to-back murabaha, back-to-back ijara, or back-to-back sukuk,' says Edwardes.

There is a major problem facing IFIs in terms of 'the lack of tools available for risk management and risk profile alteration', he thinks. The need to address asset liability management and the yield curve management in IFIs should be met and catered for. Edwardes asks: 'Should the Islamic finance industry be scurrying around trying to replicate each and every complex derivative rather than focus on what is actually needed?

'Maybe the way ahead is not to talk about structuring Islamic derivatives with all of the connotations of gambling and uncertainty; let's focus on financial takaful,' he suggests. Going back to basics and addressing the problems that derivatives were originally designed to address may be the way forward. Islamic banks would then have Shari'ah-compliant tools that would help solve the real asset/liability and risk management issues faced by Islamic institutions, both financial and commercial.

...To create Islamic derivatives without getting close to the edge, go back to first principles, to when derivatives were first created.

Financing the Poor: Towards Islamic Microfinance

This symposium held at Harvard University brought together a diverse group of international speakers and a number of noted individuals from the microfinance and Islamic finance sectors. Nazim Ali, director of the Islamic Finance Project (IFP) at Harvard Law School, gave the opening address, and reports on the event for NewHorizon.

Microfinance is not reaching the poorest of the poor, even though this is its purpose, and loans are going to activities unrelated to entrepreneurship. Islamic finance could, in principle and in practice, correct these defects.

The Islamic finance sector has for some time focused on the development of its business, including the standardisation and consolidation of the industry. This approach has marginalised a large number of 'unbankable' members of society. Microfinance is one such area that has been neglected by the industry, and many financial institutions around the world are working to address this – not just for philanthropic reasons, but because this is a vast sector on which they can capitalise. The Islamic International Ratings Agency (IIRA) is currently involved in discussions with the Islamic Development Bank as to how to promote microfinance in Muslim countries. Financial institutions such as Deutsche Bank and the Islamic Bank of Thailand have also decided to venture into Shari'ah-compliant microfinance. Other efforts are under way on an experimental basis, although it is more difficult to provide a detailed account of these.

While Islamic finance aspires to create an equitable economy, it has in the eyes of many become a banking system for the rich. Conventional microfinance, meanwhile, has demonstrated success as a tool to help reduce poverty and encourage economic growth in neglected, rural parts of the world, but the flip side of this coin reveals criticism of the industry's tendency to charge the poor exorbitant interest rates and fees. These are often necessitated by the high transaction costs incurred in microfinance, including the provision of services to monitor and supervise entrepreneurial endeavours, health insurance, and so on. With the two industries sharing the common goal of social justice, the aim of the IFP symposium was to bring together representatives from both, so that each party could learn from the other and move towards a viable system of Shari'ah-compliant microfinance.

The IFP symposium wanted to explore the role of the Islamic finance industry as a source of funding for microfinancing initiatives and to serve as a medium to promote alternative financial instruments within the Islamic finance industry. With many microfinance services offered on a not-for-profit basis, the viability of harnessing traditional Islamic financial institutions that use zakat and waqf as a source of funding was discussed. Also considered was the potential collaboration between industry and academia to provide better tailored microfinance models which would serve the needs of increasingly sophisticated microfinance institutions, while simultaneously creating alternatives, with lower service costs and increased accountability and transparency, for borrowers on the ground.

Misconceptions about intangible hurdles which have to be overcome within the Islamic finance industry, as well as microfinance, were aired within the symposium. Many suggestions were offered as means of overcoming sources of mutual misunderstanding, with a view to better serving the poor, particularly in Muslim economies. Communication is key.

Baber Johansen, acting director of the Islamic Legal Studies Program and affiliated professor at Harvard Law School, chaired the symposium. He opened the session by commenting on the burgeoning interest in financing the poor and the Islamic finance industry's long-standing desire to promote equitable economic development. In his opinion, this offers a strategic approach towards a charitable goal.

Robert Annibale, global director of microfinance for Citigroup, was the first keynote speaker. He shared his insights into both Islamic finance and microfinance. He described microfinance institutions as self-styled 'bankers of the poor', originally rooted in domestic, local markets but increasingly expanding into larger markets and offering a broader range of services. He noted that the high operating costs, passed on to the customer in the form of high interest rates, are a hurdle for the poor. Annibale encouraged institutions to try to make their operations more cost-effective, because the customer inevitably pays for any inefficiencies. He felt that this was where there is potential for Islamic finance to make a difference.

Under conventional microfinance, risk is borne by borrowers and rarely held by the institutions. Non-governmental organisations (NGOs) and other non-profit institutions offer efficient services to supplement their lending, but these services add to the cost base. Islamic finance focuses on interest-free methods of providing capital, because the Shari'ah holds lending to be a purely charitable exercise, rather than a means of making a profit. Islamic finance is also accustomed to methods of risk–reward sharing between the institution and the borrower.

Taking a step back, Annibale then reviewed the market, highlighting the work of the Microfinance Information Exchange and its transparent analysis of microfinance groups. He noted that there were only small-scale microfinance offerings across North Africa and Pakistan and that competition in this part of the world would be beneficial. Indonesia and Bangladesh, on the other hand, have more developed microfinance markets. In fact, microfinance institutions enjoy greater penetration than traditional commercial banks in Bangladesh.

Microfinance has grown significantly in India, but the industry there faces a number of restrictions, imposed to protect customers from very high interest rates, as well as objections raised against usury and exploitation from religious leaders. In his closing remarks, Annibale stressed that the industry is in need of competition and innovation if it is ultimately to be of benefit to its customers.

Aamir Rehman, former global head of strategy at HSBC Amanah, presented the second keynote address on behalf of Iqbal Khan, HSBC Amanah's founding CEO. Rehman considered the extent to which the Islamic finance ethos is compatible with the spirit of microfinance. From the perspective of the Shari'ah, Islamic finance should focus on ethics and values that encourage community-based, alternative programmes to promote genuine economic activity. As a nascent industry, however, it still faces a number of challenges to its credibility in the finance world. As a result, it has focused less on the alleviation of poverty in the past because it has been working to meet world-class banking standards and to serve its clients in a Shari'ah-compliant way. At the same time as being seen as a viable system of financing, it has had to prove itself to be profitable as well. While the social goals of the Shari'ah are important, Rehman stressed that Islamic finance has to meet commercial standards first. He added that the industry has had to move from a consumer-debt industry to a savings industry, dovetailed by micro-finance, because it assists business development and economic activity.

If Islamic finance and microfinance could converge, the industry could reach a three billion person market. Trade, Rehman reminded the audience, has played an integral part in the spread of Islam and Islam has a long history of valuing trade and entrepreneurship. Moving on, Rehman described how traditional banks seek growth through the expansion of customer debts while Islamic banks have tried to move away from this debt-based approach. He could envisage a paradigm shift in Islamic finance away from a 'Shari'ah-compliant' to a 'Shari'ah-based' industry, which uses its commercial services to partner with microfinance institutions with access to rural and poor communities.

Following these two keynote speeches, proposals for, and case studies of, Islamic microfinance were presented in the symposium's first panel session. The session was moderated by Asim Khwaja, associate professor of public policy for the JFK School of Government, Harvard University.

Opening with an alternative view of microfinance, Samer Badawi of the Consultative Group to Assist the Poor (CGAP) expressed the view that, while there is evidence to support the value of microfinance, there is also alarming evidence to the contrary. Microfinance is not reaching the poorest of the poor, even though this is its purpose, and loans are going to activities unrelated to entrepreneurship. Islamic finance could, in principle and in practice, correct these defects.

Professor Hans Dieter Seibel from the University of Cologne, Germany, presented a case study on Indonesia, the largest Muslim country in the world, with a mixed history of Islamic microfinance. Seibel noted that Islamic microfinance banks have statistically not done well compared with their conventional counterparts. Absentee ownership, together with a lack of competence in Islamic finance, have been partly responsible for this, but mudarabah savings and fixed deposits have still been successful. Seibel also emphasised that a proper legal framework and regulation of interest rates are important factors in the success of Islamic microfinance.

Contrasting Afghanistan with Indonesia, Siraj Sait, a senior lecturer in law at the University of East London, talked about the Global Land Tool Network (GLTN), which uses Islamic land tools as a means of empowering the poor. The goal is to create pro-poor, scalable, and replicable tools; to cross-fertilise generic tools with Islamic tools; and to define stakeholders. He also highlighted end-user scepticism over Shari'ah compatibility and lack of state regulation as representing challenges for the industry.

Taha Abdul Basser, a Ph.D. candidate at Harvard University, presented a paper by Dr Muhammad Anas Zarqa, advisor to the International Investor company. Basser explained that, as a young industry, Islamic finance still has to focus on social justice. In order to do so, it has to be more convincing to its clients and it needs to hone managerial talent. Basser discussed the viability of the Islamic instrument of monetary waqf (cash trust) as a means of financing Shari'ah-compliant microfinance. In addition to initial donations, a monetary waqf further mobilises temporary funds that can be extended to the productive poor as microcredits. Basser presented Dr Zarqa's opinion that there should additionally be two tiers of philanthropic guarantors for a monetary waqf to strengthen its security standing: guarantors of liquidity and guarantors of losses. Not only would this help to increase the credit standing of a waqf, but it would also attract a considerable quantity of temporary funds.

Saif I Shah Mohammed, from the Columbia University School of Law, spoke next. He agreed with Badawi that microfinance had been over-hyped. Mohammed was of the view that a partnership between Islamic finance and microfinance would offer the best approach, especially in the case of Bangladesh. He pointed out, however, that Islamic microfinance institutions need to overcome distrust in the microfinance market and clarify terms that have in the past caused confusion. Mohammed also appealed to Shari'ah scholars to take a proactive role in clarifying these terms for the population.

The second session was moderated by Samuel L Hayes, III, Jacob Schiff professor emeritus of the Harvard Business School. The panellists spoke of the challenges of integrating Islamic finance with microfinance. Shari'ah scholar Sheikh Nizam Yaquby noted that the fight against poverty is an important one for Islam and for microfinance. But he pointed out that, unlike conventional microfinance, Islam does not allow exploitation with higher returns. Nadeem Hussain, president and CEO of Tameer Microfinance Bank, expressed his reservations that the lack of fundamental assets make it difficult to apply microfinance to Islamic finance.

The speakers also contended, however, that these issues could be resolved if people from the Islamic finance and microfinance sectors were to work together. Aamir Rehman and Robert Annibale reiterated that a hybrid model, integrating philanthropic and commercial goals, or a not-for-profit model using charitable sources such as zakat, offer a relationship between the Islamic finance and microfinance industries.

Michael Ainley of the UK Financial Services Authority (FSA) compared the current development of microfinance with Europe's transition from credit unions and community banks to its contemporary economic system. Ainley also noted the importance of effective government regulation and supervision of the industries in this process. Aqil Abdus Sabur, interim president of the Philadelphia Commercial Development Corporation, linked the discussion through microfinance as practised by the Prophet Muhammad's (PBUH) companions over a thousand years ago.

The panellists offered closing remarks, reminding the audience of Islam's history in finance and the scope of potential for Islamic microfinance. This is a project that is growing in the US and the UK, as well as in the rest of Europe, the Middle East, and Asia. As Sheikh Nizam Yaquby advised the session, however, it is important to bear in mind that the goal is to eliminate poverty, not to cloak goals to exploit people.

If Islamic finance and microfinance could converge, the industry could reach a three billion person market.

Sixth sense

It's a well known fact that the take-up of Islamic banking is expanding at a rate of knots across the globe. But how is it faring in an Islamic heartland such as Pakistan? Tom Alford, NewHorizon's contributing editor, talks to a new entrant in that market, First Dawood Islamic Bank, to find out the state of play.

Despite Pakistan being an Islamic country, its banking market has to date remained mostly served by non-Islamic institutions. But, as with the Malaysian market some 20 years ago, it is changing – and changing fast. With the total assets of Islamic banking institutions in the country almost tripling to 54 billion rupees ($899.1 million) in the fiscal year 2006, from 18.8 billion rupees ($313.02 million) at the end of 2005, the local market is taking on a decidedly wholesome new shape.

Although Islamic-banked assets currently only represent around three per cent of the total in Pakistan, Islamic banking is clearly reaching out to its people more than ever. It is now available in 16 cities in all four provinces of the country through fully-fledged Islamic banking operations – banks such as Meezan Bank, Al Baraka Islamic Bank, BankIslami Pakistan, Emirates Global Islamic Bank, and Dubai Islamic Bank Pakistan. But in addition to these exclusively Islamic financial institutions, some 39 branches of eleven conventional banks are also providing exclusively Islamic banking services to their customers.

And with the likes of Qatar Islamic Bank known to be looking to make an entrance into Pakistan, it could not have been more fortuitous for First Dawood Islamic Bank (FDIB) to have opened its doors last April as the sixth fully Islamic bank in the country, just as the State Bank of Pakistan's (SBP) attitude to licensing changed.

It now looks rather as if SBP is to draw a line under the 40 or so banks currently operating in the country and will not be issuing any more new banking licences in the foreseeable future. 'I like to believe that we are one of the last banks to get an Islamic licence [in Pakistan],' says FDIB's CEO, Nikolaus Rafiq Schwarz, convinced of FDIB's good fortune.

I like to believe that we are one of the last banks to get an Islamic licence [in Pakistan].

Nikolaus Rafiq Schwarz, FDIB CEO

And as the head of a new, lean operation with a universal banking remit, Schwarz is setting his sights on taking advantage of this dynamic segment, especially while further competition is effectively being stifled. In fact, the Karachi-based single-branch FDIB is touting aggressive growth plans by scheduling another eight offices for opening this year alone.

The percentage of booked Islamic assets to date is proof-positive for Schwarz that there is considerable 'room for growth', to the point where the market, despite what SBP says, could even 'digest a couple more Islamic financial institutions'.

The mention of Malaysia in the opening paragraphs is no idle reference. Schwarz believes the development of the Islamic banking market in Pakistan is taking a similar route to that of the South East Asian country.

Here, the government has a highly supportive Islamic banking framework that it has built up over the past 15 or 20 years, allowing it to harbour almost a quarter of all banked assets in the country.

Malaysia and Pakistan share a structural approach to banking that is not found in the GCC for example, being considerably more in favour of universal banking operations, whereas the GCC region prefers to offer more niche investment and private banking-type services.

Whether Pakistan can emulate Malaysia's economic pattern is yet to be seen, of course. But FDIB's wide-open remit to catch as much corporate and consumer trade as possible seems to be in tune with the brandishing of its heroic growth strategy. Although in terms of capitalisation it is, in Schwarz's words, 'a lot smaller than most of the Islamic institutions', FDIB is still in a reasonably strong financial position to reach out to the local market in flamboyant fashion.

Prior to opening its doors for business, it had secured initial capital of two billion rupees ($33.3 million), with its three major investors each taking a 21 per cent stake. Bahrain-based Unicorn Investment Bank, Pakistan's First Dawood Group, and the Islamic Corporation for the Development of the Private Sector (a unit of Jeddah-based Islamic Development Bank) are now happy to promote the aggressive growth plan espoused by Schwarz and his board. In addition to the branches to be opened by the end of this year, the blueprint talks of a further 18 branches and offices opening throughout 2008.

On a practical level, expansion by this degree holds no fear for Schwarz and his team. 'What we are doing is pretty modular,' he says explaining the physical layout of each branch. Indeed, every office follows a formula and is practically pre-built and slotted into the chosen premises. 'We can open a new small branch in about four weeks,' he claims.

The expanding network will be held strong by state-of-the-art Shari'ah-compliant core technology from Sungard System Access. This has been assessed in close co-operation with Yasaar Ltd, an international Shari'ah consultancy, with thorough attention from one of its most eminent scholars, Dr Daud Bakar.

The core technology will be complemented by the most effective delivery channels for the region which will include branch, internet, call centre and SMS banking ('very important in Pakistan').

Schwarz sees technology as one of the bank's key differentiators. 'We have to try to be more technology-driven than other banks here,' he declares. He is, of course, mindful that FDIB needs to offer a rich package of product, technology and customer experience to stand a chance of seriously competing with the bigger, more established players in Pakistan.

The technology may help deliver efficiency and customer delight, but how does its product-set stand up? Although Schwarz describes FDIB's initial offering as 'plain vanilla', he is quick to explain that this is all part of the plan to get the single-branch operation established before engaging in more complex and exotic instruments for its corporate and private customers. 'First we need to establish ourselves as a credible financial institution in Pakistan,' he states.

The follow-on offering is likely to include a unique (for Pakistan) ijara product to enable customers to save for their Hajj and Umra. Continuing the Malaysian connection, this sort of product has been available in that country since 1963 and is now administered by Lembaga Tabung Haji, or the Pilgrim Fund Board of Malaysia.

FDIB is also looking to offer differentiation in structured finance products, partly as a benefit of its major shareholders' own banking know-how. 'This is what we would like to focus on in the coming months,' says Schwarz, stressing that the idea is not to create two pillars of banking where an investment banking division works 'in parallel' with a corporate banking division: 'It confuses customers,' says Schwarz.

With the emphasis on being a unified operation, FDIB is looking to expand its client portfolio quickly but progressively. After eight to twelve months of growth, it intends to return to its clients with more sophisticated offerings and engage in some serious cross- and up-selling.

For now though, FDIB's 'plain vanilla' offering encompasses deposits under the branding of Al-Mustaqeem, such as current accounts, saving accounts, term deposits, receipts and basic banking accounts. It also delivers Al-Mustaqeem branded financing which includes a murabaha facility for the purchase of Shari'ah-permissible raw materials and commodities. In addition, an ijara wa iqtina (Islamic leasing) facility provides finance for the purchase of machinery and equipment for new projects and business expansion.

Car ijara and housing finance are available for the salaried and self-employed, while the diminishing musharakah facility provides finance for capital expenditure in the construction and manufacturing industries. In the trade finance realm, as a first in Pakistan, FDIB is also offering under the Al-Mustaqeem brand, a service ijara product, a post-shipment export facility and a local goods supply finance product. 'FDIB is also offering a very innovative running musharakah facility,' says Schwarz.

The bank's first tough test will come in the form of regional commercial competition from global banks such as HSBC Amanah, Deutsche Bank and Citibank. These tier one institutions are potentially a threat to a small operation like FDIB.

Although he believes many of the Islamic offshoots of the global players in Pakistan do not really cover 'the full spectrum of corporate finance and consumer finance', Schwarz is realistic enough to acknowledge that if any of these banks decided to step into the fully-fledged Islamic banking limelight with a fuller set of products, their vast scales of economy would be 'very difficult' to overcome.

For now though, he remains 'very optimistic' about FDIB's prospects. Although over the next twelve months or so the bank intends to stay within Pakistan's borders protecting its rapidly expanding local interests, the exponential growth of Islamic banking in the region will surely see FDIB adding to its client base.

There's no shortage of willing customers. Indeed, wherever an Islamic financial institution opens in Pakistan, Schwarz, clearly happy to scoop up the new business, reports waves of clients 'closing their accounts with non-halal banks' and moving into the world of Shari'ah-compliant banking.

Putrajaya Mosque, Malaysia

Malaysia: Leading the way

This 'Asian tiger' is on top of the game with its Islamic banking and insurance markets extensively developed and firmly established. Tanya Andreasyan, NewHorizon's editor, reflects on the commitment displayed by the Malaysian government to facilitate and promote Shari'ah-compliant finance both domestically and globally.

Malaysia and the GCC (Gulf Cooperation Council) countries are the key players in the global Islamic finance market today. The Middle East has led the way in launching the modern notion of Shari'ah-compliant financing, with the first commercial Islamic bank – Dubai Islamic Bank – appearing in the United Arab Emirates in 1975 (although the Islamic banking experiment had begun a decade earlier in Egypt, proving unsuccessful at that time for a number of reasons). The establishment of Dubai Islamic Bank in the UAE preceded the creation in the same year of Islamic Development Bank in Jeddah, which had turned the theoretical ideas of banking according to Shari'ah into practice. A number of other GCC countries followed, including Kuwait, with the opening of Kuwait Finance House in 1977, and the Kingdom of Bahrain with Bahrain Islamic Bank, launched in 1979.

A few years later, Malaysia embarked on its own Islamic finance development project, something that had its roots in the 1960s, when the revival of Islam in the country had really taken hold (the country's Muslim population today comprises 16.3 million people, over 60 per cent of Malaysia's total population). Up until then, Muslims performing pilgrimage to the Holy Land in Saudi Arabia could not save money to finance their journey through conventional banks as their transactions involved usury. In response to this need, the government founded the Pilgrims Fund Corporation, also known as Tabung Haji or TH for short, which commenced operations in the early 1960s and continues to function today. Its main purpose has always been to enable Muslims to save for their pilgrimage and other beneficial purposes in a Shari'ah-compliant way and to ensure the pilgrims' welfare during their journey by providing various facilities and services.

In 1983/4, the Malaysian government passed the Islamic Banking Act (IBA) and the Takaful Act, the legal basis for establishing Shari'ah-compliant banks and insurance companies in the country. This legislation has provided the country's central bank, Bank Negara Malaysia (BNM), with the authority to supervise and regulate Islamic financial institutions and takaful operators. In 1983, the first Shari'ah-compliant bank was launched – Bank Islam Malaysia Berhad.

This was the take-off point for the development of Islamic banking in the country. Since then, the government has introduced a number of supporting measures, and beyond all doubt, this high level of government support has played a significant, if not major, role in establishing Malaysia as a leading centre for Shari'ah-compliant finance on a global scale.

Bank Islam remained the only Islamic bank in the country until the early 1990s, originally catering primarily to the financial needs of the Muslim population, but gradually extending its services to the general public regardless of their faith. Today, the bank has a network of over 90 branches across Malaysia and offers around 50 innovative Islamic financial products and services.

In 1993, Bank Islam saw its first competitor arrive, surprisingly not in the form of another domestic Islamic financial institution, but as an Islamic window of a conventional foreign bank, Standard Chartered. It was not until 1999 that the second fully-fledged Shari'ah-compliant bank, Bank Muamalat Malaysia Berhad, was launched. The reason for this rather slow start can be explained by the Asian financial crisis (also known as the East Asian currency crisis), which developed in 1997, affecting Malaysia amongst other Asian countries. BNM took a number of measures to overcome this period of economic unrest, including setting a fixed exchange rate for the national currency, the ringgit, which remained fixed until 2005.

Nowadays, there are eleven Islamic banks and eight conventional banks with Islamic windows operating in Malaysia. Four of them commenced operations in 2006. The number of branches offering Islamic banking products and services rose from 766 in 2005 to 1167 in 2006.

Shari'ah-compliant products and services offered in the country's banking market today are based on a variety of Islamic concepts including bai bithaman ajil (sale of goods on a deferred payment basis), mudarabah (profit and loss sharing), musharakah (joint venture), murabaha (the bank buys and sells items required by the customer at a mark-up), ijara (leasing), qard hasan (microfinance), and istisna (contractual agreement for manufacturing goods and commodities).

Petronas Twin Towers, Kuala Lumpur

Robust development can also be observed in the takaful (Islamic insurance) sector, with four new players setting up operations last year, effectively doubling the total number of takaful operators in the region (bringing the number to eight) and increasing the industry's revenue to 8.2 per cent of the total insurance sector revenue.

Currently, the takaful business carried out in Malaysia can be broadly divided into two categories – family and general. The first category is described as 'a combination of long-term investment and a mutual financial assistance scheme' by BNM. It includes takaful mortgage plans, takaful plans for education, and health and medical takaful for both individuals and groups. Contributions paid by participants to these schemes are split and credited to the Participants' Special Account (on the basis of tabarru – a donation covenant) and the Participants' Account (for savings and investments only).

The second category is 'purely for mutual financial help on a short-term basis, usually twelve months, to compensate its participants for any material loss, damage or destruction… arising from a misfortune that might inflict on his/her properties or belongings'. It offers a number of covers, such as fire, motor, marine, aviation and transit takaful schemes. The contributions paid into the general takaful fund are wholly based on the principle of tabarru.

To support further development of the takaful and retakaful industry in Malaysia, BNM is inviting 'strong and qualified' retakaful players to set up their operations in the country. This was announced by BNM at the 3rd International Convention of Takaful and Retakaful held in Kuala Lumpur in August of this year. Under this initiative, retakaful operators licensed by the central bank will be able to conduct their business in ringgit and international currencies. There is also the choice of carrying out operations as an incorporated entity or as a branch. Foreign applicants are welcome too – they can operate through joint ventures with Malaysian companies. It is expected that a strong retakaful market will, firstly, fulfil the need of takaful operators for retakaful support and, secondly, reduce the industry's dependency on conventional reinsurance support.

Needless to say, both Islamic insurance (although this industry still experiences a number of challenges, including shortage of talent) and Islamic banking in Malaysia have evolved dramatically since their early days when the range of Shari'ah-compliant products and services was very basic. Two decades ago, Bank Islam offered only a handful of deposit and financing products, whereas today it has expanded its range from traditional savings and investment offerings to include leasing, stockbroking, unit trust management and treasury-related products.

Another key player in the Malaysian Islamic banking market, CIMB Islamic Bank Berhad, is also tangible proof of the industry's extensive development. Although this bank was officially launched just four years ago, the experience and roots of its management go all the way back to the 1990s, to Bank Muamalat. 'Of course, we have evolved in different ways since then,' states Badlisyah Abdul Ghani, chief executive of CIMB Islamic. 'We have evolved in all aspects of the industry: consumer banking, investment banking, asset management, takaful and private banking.'

With an extensive range of sophisticated Islamic products, Shari'ah-compliant banks are enjoying rivalling their conventional counterparts right across the board. For example, prices for Islamic and conventional retail banking products and services are about the same. On the bond issuance side, Islamic bonds are 'more attractive to consumers in terms of pricing', according to Ghani, as they are 'always cheaper than conventional bonds, typically five to ten basis points so'. As a result, he says, 'there are more investors chasing Islamic bonds than there are supplies'.

In addition to competing with conventional financial institutions, Islamic banks in Malaysia are, naturally, also engaging in

healthy competition with each other for a slice of the Islamic finance pie. 'It has always been a highly competitive market,' says Ghani. 'But we are experiencing a more exciting market – the methodology in marketing is different now; banks do more marketing than before. Whilst before it was more word of mouth, now it is more explicit advertisement. The market is becoming more aware of Islamic banking and finance now.' Although many people feel that the competition has recently 'heated up', he adds, it is actually the same players (with the inclusion of some new ones) with 'a bit more of market awareness than before'.

There is, however, a very important restriction in the field of advertising imposed by BNM, and this is a strict prohibition of using Shari'ah as a marketing tool. 'A bank cannot go into the market and start condemning somebody else's product, saying that it is not halal or less halal than their bank's,' says Ghani. This is done in order to protect the consumer. If an Islamic banking product is present in the Malaysian market, it means it has been approved by the Shari'ah Advisory Council for Islamic Banking and Takaful (SAC) – the ultimate authority on Shari'ah compliance in Malaysia, established by the central bank. This way, consumers can be certain that the products they are buying are Shari'ah-compliant. 'We did away with the incessant debate that has no place in Shari'ah,' states Ghani.

Each and every Islamic financial institution in Malaysia licensed by the central bank must have its own Shari'ah board, which subordinates to SAC. People sitting on these boards must be qualified and endorsed by SAC. The Shari'ah board of a Malaysian bank is responsible for dealing with relevant matters in that particular bank and ruling on the compliance of the bank's products and services with Shari'ah law. But before introducing any Islamic banking product or service to the market, the board passes it to SAC for approval. Once sanctioned by BNM and SAC, it becomes available to all banks to take on board if they wish. 'The Malaysian regulator does not discriminate against any school of law under Shari'ah,' says Ghani. 'A decision made by any school of law, as long as that school of law is recognised under Shari'ah, will be endorsed by the central bank. And the moment it is endorsed, it becomes available and eligible as a Shari'ah-compliant product for the whole market.'

This approach is very different to some other Islamic finance centres, such as for example, Bahrain, which is also among the world's leading Islamic finance hubs. There, the central bank's supervisory Shari'ah board does not centralise the decision-making process concerning Shari'ah compliance issues of individual banks and does not interfere in these processes.

Ghani believes that the Malaysian approach is advantageous, as it results in standardisation and harmonisation within the industry. 'I've always believed that the regulator must regulate the Islamic banking industry, and that includes regulating Shari'ah,' he says, adding that such tactics also help in cutting the costs of research and development, and in facilitating the growth of Islamic finance.

And the industry is indeed growing. The Malaysian government is encouraging domestic banks to go global. Last year it introduced a tax incentive to motivate Malaysian financial institutions to expand overseas.

In tune with this initiative, Bank Islam has adopted a 'go global' attitude since last year with the arrival of new shareholder, Dubai Investment Group; and RHB Group, one of the largest financial services corporations in the country, with Malaysia-based RHB Islamic Bank under its umbrella, has taken its operations across Asia and now covers Singapore, Indonesia, Thailand, the Philippines and Brunei.

CIMB Group (of which CIMB Islamic is part) currently has a presence in twelve countries. 'We undertake Islamic finance and banking, in one form or another, wherever we are present,' explains Ghani. 'It all depends on the demand in the particular market. Of course, the pre-dominant business for us overseas is whole-sale – in investment banking, sukuk issuance, project financing and so on.'

In their turn, foreign finance groups have been keen to enter the Malaysian market. Qatar Islamic Bank, Al-Rajhi Bank (headquartered in Saudi Arabia) and Kuwait Finance House are among those who have set up subsidiaries in Malaysia. In January of this year they were joined by Asian Finance House (owned by investors from GCC countries) and, several months later, HSBC Malaysia, which already had a well-established presence in Malaysia in the field of conventional finance, was granted an Islamic banking licence. According to HSBC Malaysia's CEO, Irene Dorner, now the bank will be able to open more branches – five in the first year and increasing to 15 over a two-year period.


Kuala Lumpur

With plenty of experience to share, Malaysia also offers assistance in developing Shari'ah-compliant finance outside its borders. In a recent meeting between the prime ministers of Malaysia and Thailand, the question of cooperation in the field of Islamic banking was high on the agenda. The meeting focused on widening and strengthening the bilateral relationship between these 'Asian tigers'. Malaysia's prime minister, Datuk Sri Abdullah Ahmad Badawi, stated that his country was prepared to offer the necessary assistance (including technical aspects) to establish Shari'ah-compliant banks in Bangkok and southern Thailand. 'We will have talks in the near future to further discuss this matter,' he announced at the press conference following the meeting.

And closer to home, Islamic finance continues to go from strength to strength thanks to a number of recent initiatives from Bank Negara Malaysia and the country's government. The Malaysia International Islamic Financial Centre (MIFC) initiative was launched to promote Islamic financial products and services in international currencies for the global market.

This is often referred to as a 'one-stop shop' for Islamic banking by industry specialists, and it is set to compete with such prominent Middle Eastern hubs as Bahrain (extensively covered in the January–March 2007 issue of NewHorizon), Dubai International Financial Centre and Qatar Financial Centre. London, with its drive to become a market leader in this field (for full story see NewHorizon, April–June 2007), also has to make room for MIFC on the world stage.

'MIFC is effectively the next phase in the development of the industry,' says Ghani. First, the Malaysian government concentrated on establishing a 'stable and sustainable domestic Islamic financial market'. Now, the market is ready for 'non-domestic transactions'. If the country has until now focused on the development of the ringgit market, now the time is right for developing the international currency market 'using the existing intermediaries that have been doing business in Malaysia for some time and also encouraging new players to come in'.

One of the principal objectives of MICF is to establish Malaysia as a centre for origination, distribution and trading of sukuk. It was Malaysia who pioneered this Shari'ah-compliant type of government bond in 2001. The main difference between conventional and Islamic bonds is that, in conventional finance, bond trading is largely about making the most of interest rate developments, while Islamic finance requires real, concrete assets to back the Shari'ah-compliant papers.

Other countries followed, with the phenomenon of sukuk taking off and expanding its boundaries beyond South East Asia and the Middle East to reach as far as Europe. The UK government, together with the country's regulator, the Financial Services Authority (FSA), is currently laying the legislative foundation for the issuance of sukuk.

A strong regulatory framework, a wide range of Islamic bond instruments and experienced personnel give Malaysia the right to claim that it can provide, in the words of Dr Zeti Akhtar Aziz, BNM's governor, 'a total solution' for issuing and trading Shari'ah-compliant bonds. In 2006, the total value of Malaysian sukuk issues was RM42 billion ($12 billion), which accounted for over half of all local bonds issued that year. On a global scale, these figures show that Malaysia has achieved an impressive 67 per cent of the world's total sukuk issues. At the opening of the 2nd Malaysian Islamic Finance – Issuers and Investors Forum 2007, held in Kuala Lumpur earlier this year, Dr Aziz stated that 'Malaysia not only represents the largest sukuk market in terms of outstanding size, but also in terms of numbers of issuance'.

She also emphasised that, in order to 'position Malaysia as an attractive gateway for the issuance of sukuk' and 'deepen and widen the bond and sukuk markets', Malaysia has taken further steps to liberalise the foreign exchange administration rules. Now, both ringgit and non-ringgit denominated instruments can be issued in the country's capital market. To reduce the cost of Shari'ah-compliant bonds issuance, a number of tax deductions, or even exemptions in some cases (for example, non-resident investors receiving profits and dividends from ringgit and non-ringgit Islamic instruments issued in Malaysia are exempt from withholding tax), have been introduced. In addition, Dr Aziz pointed out that 'there is a stamp duty exemption for ten years on instruments relating to Islamic securities under the MIFC'.

Such innovations have been welcomed by industry players. According to Dato' Johan Raslan, executive chairman, PricewaterhouseCoopers (PWC) Malaysia, 'the wide range of tax exemptions across the Islamic finance spectrum will further establish Malaysia as a key Islamic finance centre'. PWC is a multinational corporation providing assurance, tax and advisory services, including those relating to Shari'ah-compliant finance.

The human resources factor is also high on the Malaysian government's agenda. 'When you develop an industry from scratch, you concentrate on talent development and training,' says Ghani. But what is just as important is 'the experience gained from working in a very robust and dynamic Islamic banking industry for the last 24 years'. Even without formal training, a lot of Malaysian bankers are very sought-after, both in the country and abroad, thanks to their level of expertise and hands-on experience.

Among the most recent measures adopted by the country's government in the field of

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Badlisyah Abdul Ghani
CIMB Islamic Bank Berhad

human resources is an 'executive green light' given to the MIFC secretariat by the country's immigration department to speed up applications for long-term work permits from expatriates. This, according to Dr Aziz, 'will hopefully facilitate the greater movement of talent and expertise in the area of Islamic finance in Malaysia'.

Industry players agree unanimously that the country's government is very committed to facilitating the growth of the Shari'ah-compliant financial sector. Issuing securities (the Government Investment Issue, GII), was among the Malaysian government's early initiatives to help Islamic banks meet liquidity requirements (GII are considered to be liquid assets) and invest their surplus funds. And, no less important, it allowed the banks to invest according to Shari'ah law. The rates of return, regularly set by a dividend committee, consisting of representatives from various financial and economic government bodies, vary depending on a number of factors (e.g. the inflation rate and macroeconomic conditions at the time).

Islamic Interbank Money Market (IIMM) is a good example. It is described as 'a short-term intermediary to bridge between the Islamic banks and SPI [Skim Perbankan Islam or Islamic Banking Scheme] institutions and their instruments' by the central bank.

'I think Malaysia is the only country in the world that has put in place a very comprehensive set of legislation regulation as guidelines for the industry,' says Ghani. In addition to the afore-mentioned legislative acts and changes to already existing laws, the government has also introduced guidelines on the reporting framework of Islamic financial institutions and guidelines for the Shari'ah committee management of financial institutions. According to Ghani, Malaysia is the only country to have Islamic IPO guidelines and is the first country to have an Islamic stock exchange. 'We are not just talking about it or considering it, it has already been put in place,' he states. 'So, now it is a matter of the players doing the business.'

Another major aspect that distinguishes the Malaysian Islamic finance market is that its growth and development do not depend on oil wealth, which is largely the case in the GCC countries. 'In Malaysia, it has no bearing or correlation whatsoever with oil wealth,' affirms Ghani. The country's Shari'ah-compliant industry was developed purely from the perspective of economic inclusivity.

He explains: 'When we first started developing the industry, we wanted to ensure that Muslims in Malaysia would have the ability and the means to access funding, and from there to be included in mainstream economy activities. Too many Muslims at that time were not banking but instead keeping money "under the pillow". So, we started the whole industry from a development perspective.' This strategy continued and the 'benefits are clear to be seen'. Now that the Malaysian financial market is 'fairly robust in both conventional and Islamic' sectors and there is a 'stable social and political environment' in the country, continues Ghani, 'all sectors of the population are included in mainstream economy activities'.

So what does the future hold for Islamic finance in Malaysia? In the debt capital market, Islamic papers have already surpassed conventional papers in terms of total outstanding, exceeding 70 per cent of the total issuance, with this number expected to grow further.

The Islamic banking sector currently comprises up to 15 per cent of total banking assets and it is only a matter of time until a similar pattern of substantial growth is observed in the capital markets sector. The government's target is 20 per cent by 2010 and the expectation is that it will comprise half of the total market by 2015.

'In the next few years Islamic banking will become one of the main components of the financial market in Malaysia, if not the mainstream,' Ghani believes. 'It is definitely here to stay.'


Ubudiah Mosque, Malaysia

Looking through the Islamic window

Tamer ElGindi, economist for the Japan External Trade Organization, examines Islamic banking in Malaysia, and the performance of eight banks that offer both conventional and Islamic banking.

Malaysia is classified by several economists and analysts as a hybrid market in the field of Islamic finance. With the introduction of so-called 'Islamic windows' in 1993, conventional financial institutions gained an opportunity to tap into the Islamic segment of the country's financial market.

The development of Shari'ah-compliant finance in the country was not just through the establishment of Islamic banks, there was a complete framework adopted by the Malaysian government represented in its central bank, Bank Negara Malaysia (BNM). BNM publishes annual reports with regard to the financial system as a whole, in addition to a specific section on Islamic finance. The figures used here regarding the general analysis are limited to 2005, as the 2006 BNM Annual Report does not separate Islamic banking operations.

The Malaysian financial system

The economic expansion witnessed in the Malaysian economy is reflected in the figures of its financial system. During 2006, the current account remained in surplus, the savings rate remained high, international reserves increased, and external debt declined. The largest component in the banking system is commercial banks, followed by BNM, then Islamic banks. The share of commercial banks stood at 44.1 per cent of the total financial system in 2005, while the share of Islamic banks' assets reached 2.3 per cent during the same period. There is an ongoing focus by the Malaysian government on expanding the Islamic financial sector, and this was seen in the establishment of four additional Islamic banks during 2005.

The performance of the Islamic banking system in Malaysia

The Islamic financial system has been showing impressive results in recent years and BNM has been able to incorporate it into the overall financial system. According to the 2005 BNM Annual Report, the market share of the Islamic financial system in Malaysia has expanded. The market share of Islamic assets has increased to reach 11.3 per cent of total assets, deposits reached 11.7 per cent of total deposits, and financing reached 12.1 per cent of total financing.

In terms of profitability, net income of the Islamic banking sector reached RM3.2 billion ($0.92 billion) in 2005, recording a 134 per cent increase compared to 2001. At the same time, pre-tax profits increased to reach RM1.5 billion ($0.43 billion) in 2005 with an increase of 338 per cent compared to 1999. The better profitability has resulted in an increase in return on assets, which reached 1.5 per cent in 2005 (1999: 1 per cent), and an increase in return on equity which reached 21 per cent (1999: 17.5 per cent).

In terms of assets, these exceeded the RM100 billion benchmark for the first time and reached RM111.8 billion ($32.08 billion) at the end of 2005, signalling a 209 per cent increase compared to the RM36.1 billion ($10.36 billion) in 1999. The largest market share of total Islamic assets remains in commercial banks. Their market share increased from 43 per cent in 1999 to 53 per cent in 2005. This was followed by Islamic banks, whose share increased from 32 per cent in 1999 to 39 per cent in 2005.

Total financing has reached RM67.4 billion ($19.34 billion), recording an increase of 391 per cent compared to 1999 with a sharp rise witnessed in consumer spending. Two major components stand out as the major drivers for this sector: purchase of residential property and purchase of passenger cars.

As for the major financing concepts, credit sales (bai bithaman ajil, ijara, murabaha, and istisna) remain dominant in the Malaysian market. The 2005 BNM Annual Report shows nearly 70 per cent of the financing granted by Islamic banking institutions as sales and lease-based modes. The major financing concept is still bai bithaman ajil even though its market share decreased from 48 per cent in 2001 to 41 per cent in 2005. In second place is ijara, which increased from 27 per cent to 32 per cent during the same period. Murabaha comes in third place with its market share almost the same during that time (7 per cent in 2001 and 6.9 per cent in 2005). Musharakah and mudarabah continue to represent a very small percentage (1.4 per cent in 2001 and 0.3 per cent in 2005).

The asset quality of the Islamic banking system has further improved during the period from 1999 until 2005. Although the absolute figure of non-performing financing has increased, the non-performing financing ratio as a percentage of total loans has decreased. The net non-performing financing ratio has declined from 8.2 per cent in 1999 to 6 per cent in 2005.

Finally, there was ample liquidity in the Islamic banking system with total deposits recording a 238 per cent increase from 1999. The major bulk of deposits remain in Islamic banking system (IBS) commercial banks followed by Islamic banks. IBS commercial banks along with Islamic banks constituted 81.7 per cent of the total sector in 1999, which later increased to 93 per cent in 2005.

Analysis of the performance of the banks

The following analysis of the performance of the eight commercial banks that offer Islamic financial services alongside conventional services, for a period of eight years, is based on their audited annual statements from 1999 to 2006. The banks reviewed are: Standard Chartered Bank Malaysia Berhad, Overseas Chinese Banking Corporation Limited (OCBC) Malaysia Berhad, HSBC Bank Malaysia Berhad, Affin Bank Berhad, Citibank Berhad, AmBank Group, Maybank, and Hong Leong Bank. The analysis of performance focused on three areas: profitability, liquidity, and asset quality.

Return on assets, return on equity, and return on deposits were all higher in Islamic banking operations compared to conventional ones. This supports the argument that better and more efficient management is able to turn customers' deposits into net earnings and profits.

It also supports the view that Islamic banks will tend to seek to invest in the most profitable projects since they know, for granted, that profits will not accrue regardless of the status of the project.

Liquidity ratios have also shown superior performance in favour of Islamic banking operations. This is very consistent with the belief that Islamic banks do not depend mainly on loans as is the case in the conventional system. In the conventional system, loans represent an essential part in the well-being of the bank. As a result, less cash is available at those banks compared to Islamic ones. Once again, this is supported by the higher cash deposits ratio revealed in Islamic banking operations compared to conventional ones. Islamic banks also face less financial pressure as they do not engage in the excessive loans that their counterparts do. However, it must be mentioned in this regard that a big proportion of Islamic banking operations is dominated by credit sales methods such as bai bithaman ajil, ijara, and murabaha. Although these types are classified as debt-based modes, there is one major difference between them and their conventional counterparts. In the conventional system, the majority of the loans are used for the purpose of establishing new projects or refurbishing old ones and a smaller part is used for personal credit. In Islamic banking operations, most if not all debt-based modes are used for personal purposes. These types of financing are usually less risky than project financing.

The dominance of credit sales in Islamic banking operations does stand in the way of some additional benefits though. These are the benefits that are not purely economic but social as well, being partnerships that represent a commitment to society. On the contrary, with credit sales most of the benefits usually accrue to a specific person or household who would like to acquire a certain commodity or property.

Asset quality ratios also reveal superior performance in favour of Islamic banking operations. The lower net non-performing loans (NPL) ratios for Islamic banking operations reveal better asset quality management. In this regard, there is one major reason that could help explain the lower ratios seen in Islamic banking operations compared to conventional ones. In the conventional system, a big proportion of the loans offered to clients are business loans. Should economic conditions deteriorate or a project face difficulties, the investor will not be able to repay the initial loan, not to mention the compounded interest sums. A smaller proportion of loans are offered to customers for personal needs. In Islamic banking operations, most of the debt-based modes are for personal usage. The risk evident in this type of financing is to some extent lower than that taken for the establishment of new projects. As a result, net NPL ratios are lower in Islamic banking operations compared to conventional operations.

Islamic banks also encounter a smaller ratio of write-offs as a percentage of total assets because Islamic banks are considered partners in the projects in which they are engaged. Thus, there is no incentive for them to write off any of their accounts when a project faces difficulties. On the contrary, they are likely to wait until the project adjusts itself and profits return to accrue once again.

In conclusion, the data used here has proved the superiority of Islamic banking operations compared to conventional ones and emphasised the negative outcomes of such a debt based system compared to the benefits of an Shari'ah-compliant finacial system.

	CONVENTIONAL BANKING	ISLAMIC BANKING
Return on Assets	0.94%	1.30%
Return on Deposits	1.20%	1.69%
Return on Equity	13.47%	16.20%
Cash Deposits Ratio	17.38%	18.93%
Loan Deposits Ratio	77.69%	66.08%
Write Offs	-1.31%	-0.43%
Non-Performing Loans	7.57%	5.02%

Private equity – modern day musharakah?

Islamic finance has been widely acclaimed as the fastest growing sector within the financial arena. Much of this development has occurred within the debt and related capital markets sectors – sukuk, commodity murabaha, and so on. In the mainstream financial world, a parallel area which has also witnessed incredible growth levels in recent years is the private equity (PE) sector. Now accounting for nearly a quarter of the UK workforce, the meteoric rise of the PE players has not gone unnoticed. Omar Shaikh of Ernst & Young's Private Equity Transaction Advisory Services practice, explores some of the interesting parallels between these two previously obscure, but now high profile, mainstream alternative financial products.

The importance of equity-based solutions to the Islamic finance industry

While growing rapidly, the Islamic finance industry today faces a number of challenges. This is unsurprising, perhaps, given its age. Academics and industry practitioners alike have identified a number of issues, ranging from an absence of secondary markets, a lack of consistency and uniformity of standards within Shari'ah compliance to the shortage of qualified professionals with an adequate understanding of both the Islamic and the conventional sides of the equation.

A key challenge, increasingly cited, is the perception of Islamic financial products as being overly engineered and mimicking conventional products. Previously unaccepted products, such as derivatives and hedge funds are coming to the fore. In addition, the extensive use of tawaruq and other structuring methods to create cash loans is raising the question as to the authenticity and direction of the industry. Many analysts are referring to the phenomenon of 'Shari'ah arbitrage', classing Islamic products as another series of structured products, which create 'wrappers' to overcome restrictions. Indeed, grass root opinion in the UK struggles to deal with the benchmarking of Islamic home financing against LIBOR.

The argument that Islamic home financing charges a 'profit or rent rate' not an interest rate begins to lose credibility when users realise that the 'profit or rent rate' is benchmarked against interest rates.

A number of industry practitioners, such as Iqbal Khan (founder and ex-CEO of HSBC Amanah), believe that a change in mindset is called for, by which Islamic products would become 'Shari'ah-based' as opposed to 'Shari'ah-compliant'. Similarly, Tariq Sheikh (founder of RHT Partners) comments that 'in essence Islamic finance is an equity-based, not debt-based system, and we need to develop Islamic products which are more in line with the "spirit" of the law, as much as they currently are with the letter of the law.'

A banking system based on faith and credibility (and more importantly the perception of it as being so based) is critical to the sustainability and differentiation of the Islamic finance industry.

Private equity – the elusive musharakah solution?

As in certain forms of the conventional private equity market, the concept of risk/profit and loss sharing is an important fundamental principle of Islamic finance – the principle of musharakah. The Arabic term musharakah is not actually found in classical Islamic texts on fiqh (jurisprudence) and was coined later within texts relating to Islamic financing modes. Fiqh texts refer to the concept of 'shirkah' which is translated as meaning 'sharing' and is sub-divided into two categories: shirkatul-milk (the joint ownership of a particular property by two or more people); and shirkatulaqd (joint commercial enterprise).

Whilst the principles of Shari'ah require that loss must be shared in proportion to the capital invested, whereas profit share can be set at agreed levels, in general the Islamic model for business financing encourages profit and loss sharing through equitable financial and contractual arrangements. On the face of it, the private equity model seems to provide a natural musharakah-based solution with a proven track record of success within the conventional system.

Demystifying private equity

The term 'private equity' represents a diverse set of investors who typically take a majority equity stake in a private limited company.

In Europe, the term 'private equity' is synonymous with 'venture capital' and is used to cover funding at all stages of a business life cycle. In the United States, 'venture capital' refers specifically to investments in early stage and expanding companies, whilst 'private equity' relates to involvement in more mature businesses – through management buy-outs and buy-ins, for example.

PE firms are typically structured as partnerships with two key components: the General Partnership (GP), that is, the management team responsible for making the investment decisions; and the Limited Partnership (LP), the providers of the capital. The LP commits funding and allows the GP to draw down as required for investments that meet an agreed profile. A hurdle rate is typically set by the LP to represent a minimum investment return target for the GP. Returns in excess of this are split with the GP on a pre-determined rate (often referred to as 'carry').

An alternative asset class

Traditionally, PE sits within the broader financial investment spectrum as an alternative investment class, as represented in the table below. This table has been adapted from a special paper on 'Why and how to invest in private equity', published by the European Private Equity and Venture Capital Association (EVCA).

The deal process

Private equity provides medium- to long-term finance (usually three to seven years), in return for an equity stake in potentially high-growth, unquoted companies. In the course of the holding period, the focus of the PE firm is to improve the profitability of the company, hence increasing the value upon exit. A study on PE exits in 2005, conducted by Ernst & Young's commercial advisory team, analysed the key techniques used by PE firms to increase value and measured the impact of these on the internal rate of return (IRR). Results showed that the top three interventions by an active PE firm leading to value creation lay in:

- Restructuring part or all of the business
- Changing the CEO and/or the CFO
- Effecting cost improvements

Industry challenges facing PE

Recent market sentiment, coupled with the inherent risks of unprecedented levels of gearing in an environment characterised by creeping interest rates, has produced significant public concern around the tactics of the PE firms. Old baggage and negative connotations associated with the leveraged buy-out (LBO) firms of the past, appear to be resurfacing, with strap lines such as 'PE – locust or lifeline?' being used by the business press.

The market impact, control and tax mitigation techniques used by PE firms are currently the subject of considerable regulatory and government scrutiny in the UK. This is placing more pressure on PE firms to increase their level and transparency of reporting, and is also prompting changes in tax laws to capture a greater share of the bonus payouts earned by the GPs' 'carry element' upon exits. Perhaps one of the biggest challenges facing PE firms is that they have fallen victim to their own success, to the extent that there are a number of new players in the PE arena – hedge funds, for example. This has culminated in an environment where too much capital is chasing too few quality deals.

The Middle East private equity experience

Since Islamic finance is more mature within the Gulf region, it is interesting to see how the PE industry has developed there and to review current developments in that region.

The 'sell down' model

The PE structure described in an earlier section is in common use in the United States and Europe. Some Middle East-based funds, however, use a 'sell down' model. Here, the LP is represented by a consortium, typically of tiered high net worth individuals. The GP will identify the target, undertake the due diligence, agree principle terms with the investor group and then make the acquisition. Normally, the GP will mark up the price before selling down the stake to the various investors, as per the pre-agreed terms.

The petrodollar influence

The current increase in the petrodollar has made the Middle East region flush with liquidity and has resulted in an enormous amount of infrastructure investment and corporate acquisition activity, both regional

Alternative Investments

Private Equity	Hedge Funds	Real Estate	Commodities
(VC)	Long/short	Office	Currencies
Growth capital	Global Macro	Retail	Interest Rates
Buy-out	Event driven	REITS	Natural resources
Mezzanine Capital	Arbitrage	Residential	

and overseas. Examples of this activity are: Travelodge and the Doncasters Group, both acquired by Middle East investor, Dubai International Capital (DIC); and the recent acquisition of Aston Martin by Investment Dar, the Kuwait-based Islamic PE firm.

Analysts have estimated that the region currently has approximately $1.5 trillion of excess liquidity. Part of this cash has been directed towards Shari'ah-compliant investments resulting in sukuk issues being commonly oversubscribed and Islamic banks being highly capitalised.

A report by the Gulf Venture Capital Association (GVCA) indicated that $7.1 billion had been raised in PE funds in 2006, up from $4.3 billion in 2005. Total PE fund sizes have reached $14 billion, which is a significant increase over the $78 million experienced in 2001. Early indications show that this growth rate is continuing with funds over $9 billion having already been raised in the first half of 2007.

Increase in overseas interest

The Middle East is seeing increased interest from overseas players attracted by the impressive growth rates in the region. In the past year alone, a number of multinational banks have opened offices in the Gulf and analysts at HSBC estimate that nearly one third of global project finance spend is currently going into Middle East projects. The Carlyle Group has also opened offices in Dubai from which it intends to increase its participation in regional PE deals.

The Survey of Limited Partner Interest in Emerging Markets Private Equity, conducted by the Emerging Markets Private Equity Association (EMPEA) in April 2006 found that, of the 300 LPs contacted, 65 per cent of respondents expected to increase their commitments to the emerging markets within the next five years. Portfolio diversification was cited as a key reason.

Shari'ah-Compliant private equity

A study carried out by CORECAP showed that Islamic PE promised to be one of the fastest growing areas within the PE and Islamic finance spaces. Fund-raising activity has increased with over $4 billion of Islamic funds announced in 2006. The Middle East region is seeing a number of new Shari'ah-compliant boutique firms springing up: Venture Capital Bank, which launched a $100 million real estate fund; and RHT Partners, which was involved in the AED750 million Dubai Madaares education deal. Abraaj, an established regional player, also raised a $2 billion Shari'ah-compliant fund towards the end of 2006.

In an environment of rising interest rates and pent-up demand in the Shari'ah space, the possibility of using Shari'ah-compliant financing as 'tranches' within conventional PE transactions presents an interesting opportunity. Many Middle East investors are attracted to the idea of partnering with the likes of Blackstone, KKR, Apax and Permira and, as with sukuk financing, if the price and structure is right, Islamic finance could provide a useful source of diversified funding for conventional PE firms.

The likes of conventional PE, addressed with Islamic tenets firmly in place, should result in the best of both practices. The opportunity to innovate, as opposed to imitate, has never been more timely...

Conclusion

Like private equity, Islamic finance continues to enjoy a period of strong growth. PE provides an attractive outlet for musharakah-based investment for institutional Islamic funds. This is resulting in a greater number of Islamic banks becoming involved in PE deals by setting up their own PE funds. Islamic banks should be aware however that the PE model requires a broader mindset which extends beyond financial engineering to include operational improvements, as this is a key area for driving value. To engage effectively in PE deals, Islamic banks need to ensure that they have the appropriate resources – experienced individuals with proven track records or, alternatively, they should consider partnering up with existing boutiques or deploying a 'fund of funds' approach.

At a community level

From a UK community perspective, the cross-over into the retail and SME market remains a key challenge. Perhaps Islamic finance can take on a pioneering role in this segment by adapting early stage PE techniques and applying them to the owner-managed, small business market, that is, businesses below £1 million ($2 million) in value. This is where the major part of the UK business community 'grass-roots' need lies.

The challenge is open to the Islamic finance industry and practitioners to successfully pioneer a new form of financing. The likes of conventional PE, addressed with Islamic tenets firmly in place, should result in the best of both practices.

The opportunity to innovate, as opposed to imitate, has never been more timely, as the sector is embryonic and not fixed in its structures. Creating a new identity, rooted in strong financial success, and changing the current paradigm will go a long way towards differentiating Shari'ah-compliant finance and adding credibility to the industry.

This is what the PE asset class has managed to do in the conventional sphere and, as a result, the Islamic finance industry at large can take great hope and inspiration that similar equity-based success is achievable in its own market.

Structuring Innovative Islamic Financial Products

Mohammad Shafique, IIBI editor of NewHorizon and programme development co-ordinator, presents a summary of this three-day residential workshop organised by the Insitute and held on 10th–12th August 2007 at Clare College, Cambridge, UK.

The shortage of well-trained and skilled personnel, with a thorough understanding of both the theory and practice of Islamic finance, together with a belief in the concept and total commitment to it, is one of the major obstacles to the growth of Islamic finance. While the industry is growing at a rate of 15–20 per cent per annum, the addition of new products to meet the needs of existing and new customers in a highly competitive global financial environment is key to maintaining and boosting business.

This three-day interactive workshop focused on issues affecting the development and evolution of the Islamic financial sector in the context of innovation in Islamic financial structures and techniques. The presentations and lectures sought to define the underlying techniques used in developing innovative Shari'ah-compliant products and structures, to explore the legal issues faced in structuring these products and to develop skills to help foster innovation in Islamic structures with the help of real life examples from the industry.

There have been significant developments in Islamic structured products recently – funds of different types (hedge funds, private equity and multiple asset class platforms) and capital market structures, as well as retail, corporate and investment banking products. The aim of this workshop was to introduce participants to these new developments, while at the same time engaging them and encouraging dialogue and discussion. Examples of different types of structures were put forward in every case, to help participants to improve the skills needed for innovation in Islamic finance.

Workshop group photo

The workshop was run by Dr Humayon Dar, CEO of BMB Islamic (a London-based Shari'ah advisory firm) and a prominent Islamic economist with considerable experience in Islamic financial innovation. Dr Dar was assisted by Dr Salman Khan and Ms Haliza Abd Rahim.

After providing an overview of the workshop, Dr Dar discussed the prerequisites and key ingredients of Shari'ah-compliant innovation. These included knowledge of cutting-edge developments in the financial sector allied with a deep understanding of Shari'ah and a grasp of the needs of potential customers.

Dr Khan then explored a number of innovative developments in Islamic retail banking products, with a major focus on consumer finance. Although products were being offered by Islamic banks under different names, the core principles were often either murabaha or tawaruq (or bai al-ina in the case of Malaysia). A number of highly pertinent questions were raised by participants as to the substance of the products rather than the form, as these often appeared to mimic conventional structures.

In the next session, Dr Dar gave some practical examples of innovation from the industry. He drew attention to the way developments had been achieved gradually, in incremental steps, and highlighted areas with the potential for further innovation.

Ms Rahim followed with a discussion of the various legal issues encountered when structuring Islamic financial products. As the prevalent civil law is not always compatible with Shari'ah law, hurdles and challenges can crop up from a legal perspective when structuring products – in both Muslim and non-Muslim majority countries. Ms Rahim explained some of the problems and possible solutions for these, with the help of examples.

In the ensuing session she described an innovative overdraft facility, elaborating on its underlying structure and workings, and explaining the basis of its Shari'ah-compliance, while touching upon issues relating to the facility, which are regarded by some as contentious.

Dr Dar took back the Chair to talk about the task of structuring Islamic structured products. This is one of the most controversial areas in Islamic finance but, increasingly, structured products are gaining acceptance in the market and new products are being approved by eminent Shari'ah scholars.

Dr Dar elaborated on some of the structures, related Shari'ah matters, issues pertaining to liquidity of the products and, above all, marketability issues.

In the following session, Dr Khan explained the workings of Shari'ah-compliant hedge funds. He considered their role and how they are perceived within the overall financial landscape, their potential and whether or not there is actually a need for such financial vehicles in the Islamic financial arena.

Dr Dar continued with a discussion of recent innovations in sukuk: the demand, the products and the potential of sukuk in the Islamic finance industry.

He followed this with an explanation of fiqh issues in structuring options, forwards and futures contracts, providing examples of concepts, needs and the Shari'ah permissibility of these contracts, based on the salam contract of sale.

The closing session, delivered by Dr Khan who was assisted by Dr Dar, offered a step-by-step approach to designing innovative Islamic financial products.

Iqbal Khan, founder and ex-CEO of HSBC Amanah and also a member of the IIBI's informal Board of Governors, was the principal guest on the final day. He delivered the closing address on the future prospects and challenges facing the Islamic finance industry, highlighting a number of issues which will be critical for the industry's growth and relevance to mainstream finance.

This was followed by an award ceremony, in the course of which Mr Khan presented certificates to the participants, who represented financial institutions and professional bodies from Saudi Arabia, Kuwait, United Arab Emirates, Canada and the UK.

Discover new perspectives

The Institute of Islamic Banking and Insurance (IIBI), serving the Islamic finance industry since 1991, has introduced a new look and updated its logo as part of its rebranding strategy.

The aim is to enhance the IIBI's brand recognition both nationally and internationally. Potential funders and

Previous logo

supporters of the Institute will also recognise a fresh and dynamic style which it is hoped will encourage them to support the organisation's future developments.

The project was carried out by Gavin Krasner of UK design consultancy firm, Spring London (www.springlondon.com),

Previous logo

in association with the IIBI. The updated logo with its new colour palette, imagery and typeface, is a clear evolution from earlier versions, yet at the same time it retains some of the most recognisable components of the old appearance.

It was important for the IIBI to preserve the crescent shape and the IIBI letters but, equally, to give it a more contemporary feel. Although the crescent shape is now an internationally acknow-ledged symbol of Islamic faith, it pre-dates Islam by several thousand years.

Previous logo

Whereas the crescent has been an identifiable part of the IIBI logo through-out, the letters IIBI are now more prominent. On the one hand the new look embodies continuity, while on the other it symbolises new beginnings.

IIBI INSTITUTE OF ISLAMIC BANKING AND INSURANCE

DISCOVER NEW PERSPECTIVES

New logo

The combination of three crescents in the new logo reflects the three key objectives of the Institute: education, promotion and implementation of Islamic finance in all its forms.

The IIBI letters are set at an upward angle both to reflect the IIBI's forward momentum and to acknowledge the Creator.

The Institute's slogan – 'Discover New Perspectives' – is also an integral part of the overall appearance and perception of the new IIBI identity. It strives to promote the Islamic approach in finan-cial dealings, which may also be found in other faiths, offering opportunities to all financial institutions and to all individuals to discover new perspectives capable of delivering the full benefits of socio-economic justice.

IIBI receives new accreditation

The Open and Distance Learning Quality Council (ODL QC), the UK guardian of quality for the sector, has accredited the IIBI as a provider of open and distance learning. The Post Graduate Diploma Course (PGD) offered by the Institute is making a positive contribution to the Islamic banking system by equipping students with a comprehensive understanding of the concept and operations of the system. So far, students from 52 countries have enrolled. The IIBI is currently developing a number of new distance learning courses, both in Islamic banking and finance, as well as in Islamic insurance, as part of its professional development programme to provide skill-based education and training to the industry.

UK-based Durham University has already accorded recognition to the Institute's PGD course as an entry qualification to the University's research M.A. as well as its modules on Islamic economics and Shari'ah-compliant finance.

ODL QC Chief Executive, Dr David Morley, welcomed the accreditation. 'Distance learning is the ideal method whereby an organisation such as IIBI can reach a global market with an effective and authoritative course,' he said. 'This is a sector of the financial industry which is rapidly growing in importance; it is a pleasure to see the Institute supporting and encouraging that growth with a first-rate provision.'

'The accreditation by ODL QC is a major step forward to Islamic finance education by distance learning,' stated Mohammad Qayyum, IIBI director general. 'The IIBI is expanding its range of courses aimed at reaching the largest number globally seeking to be well-versed in the principles, concepts and practice of Islamic banking and insurance.'

Promoting Islamic finance

July: The new UK tax law on sukuk

Mohammed Amin, partner, PricewaterhouseCoopers LLP discussed the changes in Finance Act 2007 and its impact on the issuance and trading of sukuk (Islamic bonds) in the UK.

Mohammed Amin MA FCA AMCT CTA (Fellow) is a tax partner at PricewaterhouseCoopers LLP and until recently led its finance and treasury network. He specialises in the taxation of Islamic finance, and is a member of the Islamic Finance Experts Group, which advises the UK Government on Islamic finance strategy.

The lecture was chaired by Mrs Josephine Crimmin, assistant director in CT & VAT Product and Process, Her Majesty's Revenue and Customs (HMRC).

Sukuk, plural of sakk, are Islamic investment instruments which represent their holders' undivided ownership interest in the underlying assets and their entitlement to the revenue from those assets. They have some features of shares in terms of entitlement to ownership but no voting rights, and also some features of conventional bonds (interest-bearing securities) by providing income on a monthly or quarterly basis (as set out in the sukuk instrument) from the underlying assets. However, technically, they are neither shares nor bonds but a hybrid of both, with more resemblance to bonds. Sukuk are one of the most rapidly growing types of Islamic financial instrument in terms of issuance levels. In order to strengthen the position of London as a leading global financial centre in Islamic finance and also to meet its objective of financial inclusion for all members of the public irrespective of faith, the UK Government has made changes in Finance Act (FA) 2007 to facilitate the issuance and trading of sukuk, referred to in the Act as alternative finance investment bonds (AFIB).

After giving an overview of sukuk, Amin discussed the AFIB legislation in FA 2007. He explained that it was not feasible for the Government to issue separate sets of tax rules for different religious communities e.g. Muslims, Jews, Hindus, Christians etc. Instead, the legislation was drafted in neutral language, although clearly intended to facilitate the issuance and trading of sukuk.

He said that AFIB rules treat sukuk as conventional bond securities for tax purposes subject to certain rules. For corporate investors the tax law for loan relationships is applied and for individual investors the tax treatment is similar to that of an interest-bearing debt instrument. No capital gains tax is applicable if the sukuk is sterling denominated and not convertible into shares. No withholding tax is applicable if the AFIB is listed on a recognised stock exchange. Amin discussed the criteria for being a recognised stock exchange for the listing of sukuk.

He mentioned that a consequence of the AFIB rules is that, in general, there should be no value added tax or stamp duty land tax/stamp duty on transfers of sukuk. Also, any discount on a sukuk issue is taxable under the same rules as apply to discounts on conventional debt instruments.

Amin then discussed ijara and mudarabah sukuk structures and went on to describe the effect of the AFIB rules on the issuance and trading of sukuk with these structures if undertaken in the UK.

On developing a secondary market for sukuk, he said that reasonable steps have been taken to accommodate the trading of sukuk in the UK and no further changes are needed in tax law. However, it may need a higher volume of issuance to facilitate the development of a secondary market for sukuk as at present most sukuk are on issue acquired by 'buy and hold' investors. He mentioned that the UK Government is currently considering whether to issue sterling denominated sukuk.

August: Islamic investment certificates – the latest innovation in Islamic wealth management

Ruggiero Omar Lomonaco, head of Islamic investor products at ABN Amro, discussed the importance of Islamic investment certificates for the Shari'ah-compliant investment landscape and how these are filling the huge gap in Islamic investment portfolios by providing access to asset classes and pay-off profiles, which were until recently unavailable to Shari'ah-compliant investors.

Lomonaco is responsible for structuring and sales of Shari'ah-compliant private investors' products at ABN Amro. Prior to joining ABN Amro, he was director of the wealth management group at HSBC Amanah, where he spent nine years structuring and developing a wide range of Islamic investment products.

The lecture was chaired by Richard Thomas, managing director, Global Securities House (UK) Ltd.

As Islamic banking grows and the volume of the industry increases, more and more funds are becoming available to be invested on a Shari'ah-compliant basis from investors ranging from the risk-averse to risk-takers. With this development, the need for Shari'ah-compliant wealth management is increasing, and continual product innovation is essential. Islamic investment certificates are a fine addition to the Shari'ah-compliant investment product range.

First, Lomonaco briefly described the structure of Islamic investment certificates. Normally, these certificates are issued in the form of limited recourse certificates, with recourse strictly limited to an equity portfolio held in a trust. The performance of each certificate is linked to an index which represents the performance of a specific asset class and additional features like capital protection and regular dividends can be added at the request of the investor. Prior to issuance, each Islamic investment certificate is submitted to Shari'ah scholars to receive Shari'ah certification.

He then gave a short outline of the screening criteria for Shari'ah-compliant investments, which exclude investment in all haram (prohibited) activities proscribed in Shari'ah law. For example, the business activities screen excludes stocks of companies involved in pornography, alcohol, pork, arms dealing, conventional insurance and tobacco, while the financial positioning screen excludes stocks of companies that have more than 33 per cent of their market capitalisation (based on the 12-month trailing average) in any one of the following:

- the interest-bearing debt of the company
- cash and interest-bearing securities of the company
- accounts receivable of the company.

He then discussed the level of liquidity in the Gulf Cooperation Council (GCC) region due to high oil prices resulting in demand for Shari'ah-compliant investment products.

He went on to describe the profile of investors, which ranges from the purists (who want to make investments in a traditional way) to the more progressive and opportunistic Islamic investors (those who will consider investing in any asset class that is Shari'ah-compliant). He then explained some products available to Islamic investors such as the capital protected note on the Middle East Islamic Index Tracker and Islamic protected notes on commodity baskets and the global property fund.

Lomonaco also explained the mechanism of investment based on an Islamic investment certificate: the investor acquires an Islamic investment certificate and the proceeds are transferred into a trust and invested in Shari'ah-compliant equities for the entire duration of the investment. At the end of the investment period, the equities are sold to a reputable third party (an investment bank) which pays a price that reflects the initial cost of the Shari'ah-compliant equity portfolio plus a profit calculated by reference to a benchmark. A number of scholars have allowed the use of a wide range of benchmarks such as Islamic and conventional equity indexes, LIBOR rates, commodities and funds, in effect giving the Islamic investor indirect exposure to these asset classes without actually investing in them.

After the presentation, attendees asked many questions which included: how the target index is fixed; whether the use of profit rate swap with wa'ad is allowed in Shari'ah; the secondary market trading of investment certificates; and what the normal times to maturity are.

Lomonaco concluded the session by saying that, while Islamic investment certificates may not be an ideal product from a Shari'ah point of view, they have certainly expanded the investment horizon in Shari'ah-compliant investments and may be instrumental in further innovation.

September: How risk proof is Islamic finance?

Neil D Miller, partner, Norton Rose, presented his views on key issues and associated risks faced by the Islamic finance industry and made suggestions to overcome these challenges.

Miller is head of Islamic finance at Norton Rose, a UK-based international law firm. His practice focuses on all types of Islamic financial products covering a wide range of asset types, investment classes and industrial sectors. He also advises on Shari'ah governance issues.

The lecture was chaired by Ms Stella Cox, managing director of DDGI Ltd, a global investment advisory firm; she is also a member of the IIBI's informal Board of Governors.

The recent turmoil in the stock markets triggered by defaults in the sub-prime mortgage sector in the US is a reminder of the potential pitfalls of credit practices in the conventional system. This is perhaps a timely opportunity to consider whether Islamic finance, which prohibits the lending of money for interest and propagates fair and just practices in financial dealings, is likely to be any more resilient to these jitters.

After discussing the key structures used in Islamic finance which include trade-based modes like murabaha and ijara, agency-based modes like wakala, and profit and loss sharing modes like mudarabah and musharakah, he explained that the Islamic finance industry faces two main risks: one is reputational risk (whether the theory of Islamic banking is being reflected in its practice) and the other is banking risk (whether risks are mitigated for its various financial instruments). He said that whilst Islamic financial theory focuses on profit and loss sharing practices, in reality, the majority of transactions undertaken so far are through trade-based methods (such as the various modes of murabaha), which may be Shari'ah-compliant but their substance may not necessarily reflect the long-term socio-economic objectives of Shari'ah. Miller explained that the transition from Shari'ah-compliant to Shari'ah-based will, over time, be very important in order to clear con-fusion in the minds of customers and the public, and to silence the critics of Islamic banking products who complain that many existing products appear to replicate conventional structures.

He went on to suggest that participants in the industry need to be aware that while the industry is being sustained by demand-led phenomena at the moment, this could change. If the scholars (or the community)


September lecture

start to require more Shari'ah-based products, the pressure to move away from transitional products will grow.

Miller then highlighted several of the tax, legal and regulatory issues which are hindering the implementation of profit and loss sharing structures in many jurisdictions.

Whilst some Muslim majority countries (such as Malaysia and increasingly the Gulf States) have made amendments in their tax, legal and regulatory frameworks to facilitate the growth of Islamic financial institutions, there are many countries in the Muslim majority world where less progress towards enabling the environment for Islamic finance is being made.

A continuing issue stems from the divergence of Shari'ah scholars' opinions – although this is less of an issue when it comes to ruling on transactions because the limited number of scholars actually maintains a degree of consistency. Also, it may not be satisfactory that ad hoc transaction-led fatawa should determine policy.

Apart from the Shari'ah Supervisory Council of Bank Negara Malaysia (the country's central bank), there is no international or central body to develop and oversee the process of fatwa issuance in financial matters.

It remains to be seen as the Islamic finance industry grows whether or not this situation will lead to structural problems, or if the process will evolve towards a satisfactory solution.

Miller discussed the issue of the governing law clause in Islamic financial contracts. This remains an area where difficulties can arise and in the English law context he mentioned that advisers need to understand the implications of the Shamil *v* Beximco judgements in this area. In many countries (including Muslim majority countries), Shari'ah law is not always compatible with local company law, so care has to be taken to avoid accusations of Shari'ah arbitrage when seeking to achieve both legal certainty and Shari'ah compliance.

He also mentioned the need to think more about the value of international arbitration as well as panels with expertise in Shari'ah-compliant finance to resolve issues, especially in cross-border Islamic finance transactions.

He concluded the session by stating that, if the Islamic finance industry is to ensure a sustainable long-term future, it must continue to differentiate itself from conventional finance. Practitioners and Shari'ah scholars should consider the substance as well as the form when undertaking and approving Islamic financial transactions and must seek to maintain the robustness and unique character of Shari'ah-compliant financial products.

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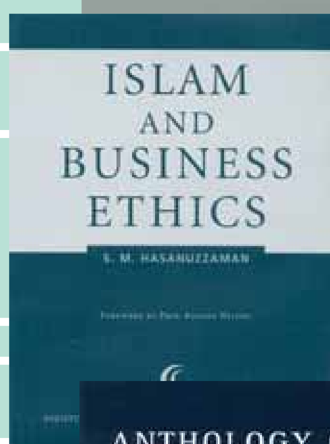

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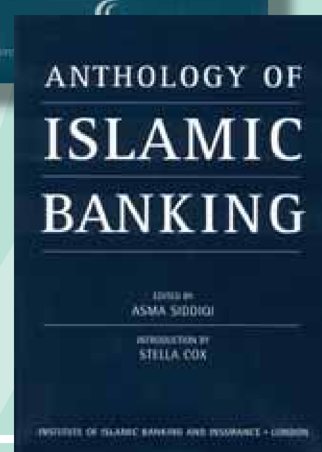

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Tales from the production line

Zafar Alam, global head of private investor products and Islamic banking at ABN Amro, gives NewHorizon the low-down on product development for Islamic finance.

More and more people want us to give them solutions that are Shari'ah-compliant on the financing side as well as the investment side.

Zafar Alam
ABN Amro

With Islamic finance, it's all well and good saying that you offer ethical, Shari'ah-compliant finance, but you also need the products to back this up. The man tasked with doing this for the Islamic side of Dutch bank ABN Amro is global head of private investor products and Islamic banking, Zafar Alam.

The bank started its Islamic side in Dubai nearly three years ago, with its main focus being on debt liability and financing. This strategy provided initial success with, as Alam puts it, 'some substantially large deals locally in UAE and in Saudi Arabia, but also in a few other places such as Turkey'. Although that focus is still there, the emphasis has now shifted slightly.

According to Alam, the bank is now looking at 'asset size and asset investment products that are more Shari'ah-compliant and more acceptable for our own Shari'ah board, as well as those of other banks who would like to buy the products'. This shift of emphasis certainly seems to have paid dividends for the bank. 'More and more people want us to give them solutions that are Shari'ah-compliant on the financing side as well as the investment side,' says Alam.

So how does a bank like ABN Amro, which caters for both conventional and Islamic finance, set about designing new products? 'Product development always starts with what the customer wants,' explains Alam. 'From customer demand you need to discuss a finer solution,' he says. This is the stage when the product team will look to meet the needs of the customer, whilst still keeping within the principles of Shari'ah. 'During this process you are always directly in touch with your Shari'ah board.' At the start of a project, a basic framework is agreed upon with the client and Alam says that then, 'you go back to the drawing board and, working with the client, you come up with the product'. During the product development stage, 'you need to draw on your own knowledge and experience of Islamic finance to know what is Shari'ah-compliant, and what will be acceptable to your Shari'ah board'.

Alam has experience developing products for conventional banking, as well as Islamic financing. Even though he says there are 'large differences' between developing products for the different forms of finance, there is an overlap when it comes to experience. 'Conventional is much more public distribution driven, it is driven by different considerations, yet there is a knowledge base, and you can use this knowledge capital for Islamic finance,' he says. 'In terms of basic products you do get your ideas from what is being sold in conventional finance,' he explains, 'but you need to know what you need to do to make it compatible with Islamic finance.' This overlap means that there is some similarity between conventional and Shari'ah-compliant products, and it is this linkage that develops the knowledge capital.

This technique of developing Islamic products out of conventional ones is something that Alam is willing to employ, explaining that 'we use some of the existing platform for new Islamic offerings'. There is a 'common thread' that runs between conventional and Islamic products at the bank. 'Our practice is to develop indices in the bank for retail,' he says. 'You can copy these indices to make an Islamic side for the project as well.' This process of product development is proving to be successful, according to Alam, and has led to 'the most popular Islamic product, the LLP structured index'.

The product range at ABN Amro has developed over the last three years. 'We started out with traditional murabaha and mudarabah products, now we have moved into sukuk and project related financing on the asset side,' he explains. Having started creating its new product line, the bank is not resting on its laurels. Alam is very aware of the constant drive for new and better Islamic finance products: 'on the structured side there's always something in the making'.

The bank is not restricted to corporate finance; it also has a retail presence in Pakistan, Malaysia, and Saudi Arabia. Alam and his team have worked on developing consumer finance products and this has led to some interesting new products. 'A lot more work has been done to come up with an Islamic credit card and mortgage in Pakistan, and we are working on more things for Malaysia,' he says.

A good product range is a factor that is helping to attract investors to Islamic finance. According to Alam, it is not only Muslims who wish to put their money into investments that do not contradict their faith, 'there is a much wider demand than purely traditional Islamic investors, it is much more widely used'. There are two main reasons he sees for this. The first is the ethical side of Shari'ah-compliant finance: 'Islamic finance is based on ethics, and it's something that is acceptable to conventional investors.' The second reason is that, for some markets, Islamic finance is the only way for investors to enter. 'Some of the exposures you want to get in the Middle East are only possible through Islamic finance and Islamic products.' For ABN Amro this creates a cross-over between conventional and Islamic finance clients. 'We see the conventional investor, traditional fund manager and traditional asset manager using Islamic finance to gain exposure to asset classes they wouldn't usually get.'

Alam can see a bright future for Islamic finance, with the bank's research indicating that 'the total pool of Islamic money has grown in multiples; it is closer to $1 trillion in terms of what funds are available'. Alam attributes this growth in part to rising oil prices. 'This adds capital from the government level, down to the individual level, and that tends to have a multiplying effect.' This money in the system means that people are looking for new investment opportunities, 'from the traditional short-term trade financing products, to long-term projects, such as financing in between people to buy investment products'. This is a shift away from traditional Shari'ah-compliant investments. 'Traditionally, the emphasis on Islamic banking has been very short-term; the investment horizon and commitments are now becoming longer-term,' he explains.

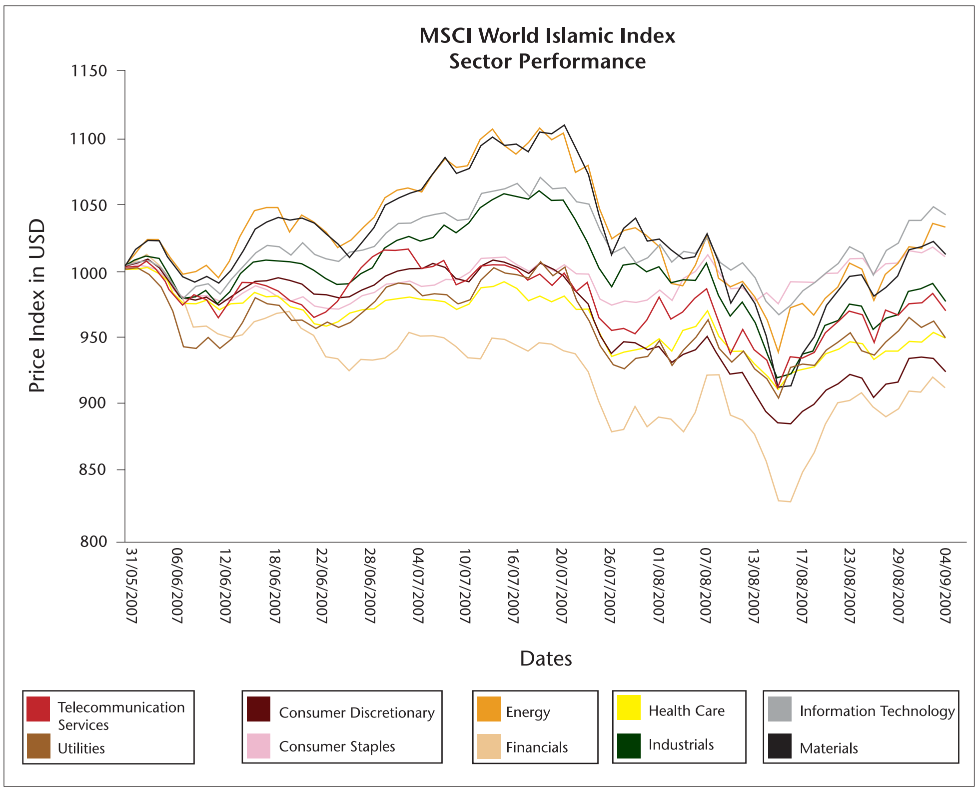
In terms of basic products you do get your ideas from what is being sold in conventional finance... but you need to know what you need to do to make it compatible with Islamic finance.

At present, ABN Amro is the subject of two rival merger bids, one from UK-based Barclays, and the other from a consortium of European banks made up of RBS, Fortis and Santander. The future of the bank at the moment is very much linked to which of these bids is accepted. Alam does not believe the Islamic side of the business will be unduly affected by whichever bid is successful. 'The merger partners are all aware of the need from a client side, it's all about what the clients are looking for, not a product offering,' he says. One of the benefits he sees coming out of any potential merger is opening up the UK market. 'The UK is a growing market, but we don't have a retail presence. It would become an important market for us with the merged partner.' In fact, at present, the Islamic side of the bank does not have a retail presence anywhere in Europe. This, however, does not exclude European investors from the bank's Islamic offering. According to Alam, 'in terms of distributing the product, we do that for investment products on the institutional rather than retail side'.

Product development, it would seem, is an area that will keep driving the success and uptake of Islamic finance. In order to keep driving this growth, the industry will need more and more customer-driven innovative products that will expand the Islamic investment portfolio.

MSCI World Islamic Index

Below is the performance of the MSCI World Islamic Index over the last month, together with sector performance since inception, sector weights and the Top 20 index constituents, provided by MSCI Barra, an indices, risk and return portfolio analytics provider. Detailed information on the MSCI Global Islamic Indices can be found on MSCI Barra's website www.mscibarra.com



SECURITY NAME	WEIGHT
EXXON MOBIL CORP	3.85%
AT&T	1.92%
BP	1.69%
PROCTER & GAMBLE CO	1.62%
CHEVRON CORP	1.49%
JOHNSON & JOHNSON	1.40%
PFIZER	1.37%
IBM CORP	1.36%
NESTLE	1.34%
VODAFONE GROUP	1.33%
TOTAL	1.26%
GLAXOSMITHKLINE	1.18%
INTEL CORP	1.18%
ROYAL DUTCH SHELL A	1.13%
HEWLETT-PACKARD CO	1.03%
CONOCOPHILLIPS	1.00%
NOVARTIS	0.96%
ROCHE HOLDING GENUSS	0.96%
PEPSICO	0.92%
COCA-COLA CO	0.87%

SECTOR	PRICE INDEX IN USD	MTD	WEIGHT
Energy	1031.051	1.39%	21.34%
Materials	1010.407	-0.29%	12.74%
Industrials	976.467	-0.82%	10.03%
Consumer Discretionary	925.182	-1.03%	9.55%
Consumer Staples	1009.199	-0.44%	8.63%
Healthcare	948.810	0.18%	14.94%
Financials	913.474	0.25%	1.38%
Information Technology	1039.893	0.43%	12.29%
Telecommunication Services	969.048	-0.55%	4.34%
Utilities	949.675	-1.58%	4.75%

MSCI Barra

* as of 05/09/07

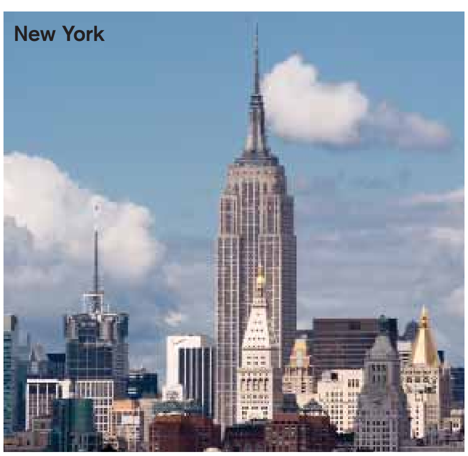
Diary of Events

October

18–20: 20th FAIR Conference, Marrakech
Conference to focus on opportunities and threats in conventional and Islamic insurance and reinsurance in the participant markets of the Federation of Afro-Asian Insurers and Reinsurers (FAIR).
Tel: +212 2246 0400
Email: scr@scrmaroc.com
www.scrmaroc.com

22–23: Product Development Forum in Banking & Finance, Dubai
Conference to focus on successful development of financial products for conventional and Islamic banking, and to look into the best practices in new-age technology product development.
Tel: +971 4361 6111
Email: marketing@fleminggulf.com
www.fleminggulf.com

24–25: Islamic Finance in North America, New York
Conference to focus on growth potential for Islamic finance in North America, the regulatory and compliance issues, and current innovations in Islamic financial products.
Tel: +1 973 256 0211
Email: info@iqpc.com
www.iqpc.com


New York

28–31: 2nd Saudi Insurance Summit, Jeddah
Summit to cover current developments of the industry (conventional and Islamic) in the country, including significant regulatory issues.
Tel: +971 4335 2483
Email: register@iirme.com
www.insurancesaudi.com

28–1 November: The 2007 Middle East Retail Banking Forum, Dubai
Conference to focus on the key issues of conventional and Shari'ah retail banking in the Middle East.
Tel: +971 4335 2437
Email: register@iirme.com
www.iirme.com

29–30: Product Innovation in Islamic Finance, London
Conference to focus on innovative Islamic investment products, their structures and the methodology behind them.
Contact: Ms Bernardine Michael
Tel: +603 2723 6604
Email: bernardinem@marcusevanskl.com
www.marcusevans.com

29–1 November: The International Islamic Finance Forum Europe, Zurich
Forum to focus on expansion of Islamic finance in the European market, including development of sukuk and Islamic wealth management and private banking.
Tel: +971 4335 2437
Email: register@iirme.com
www.iiff.com

30–31: Africa Islamic Finance Conference, Johannesburg
Conference to discuss the progress of Islamic finance in Africa and to learn about the new investment destination.
Contact: Ms Sarita Singh
Tel: +971 4336 2992
Email: sarita.singh@ibc-gulf.com
www.ibcgulfconferences.com


Jeddah

31–1 November: Islamic Financing Instruments Asia 2007, Kuala Lumpur
Conference to address the questions and issues relating to Islamic finance and the strategies in capitalising on opportunities in Asia.
Tel: +603 2070 3299
Email: sangeeta.t@abf-asia.com
www.abf-asia.com

November

1–2: International Takaful Summit 2007, London
Summit to increase awareness of Islamic insurance principles and practices, encourage open and informal debate and provide understanding of different viewpoints.
Tel: +44 (0) 20 8426 0936
Email: reza@middleeastbusinessforum.com
www.takafulsummit.com

4–5: The World Islamic Infrastructure Finance Conference, Doha
2nd annual conference to address Islamic finance infrastructure development and provide insights into the latest mechanisms for financing complex transactions.
Tel: +971 4343 1200
Contact: Anu Thomas
Email: anu@megaevents.net
www.megaevents.net

4–7: Middle East Islamic Banking & Finance Summit, Dubai
Summit to focus on key issues, latest developments and trends in the industry in the Middle East and internationally.
Tel: +971 439 761 47/48
Email: chris@acevents.ae
www.acevents.ae

6–7 November: Islamic Real Estate Finance Forum, London
Conference to focus on Islamic housing finance and Islamic real estate finance, including development, market trends, opportunities and performance of these sectors.
Tel: +44 (0) 20 8209 1751
Email: info@icg-events.com
www.islamicrealestate.com

7: Islamic Financial Intelligence Summit, London
Summit to cover the key issues, developments and opportunities in Islamic finance around the world.
Tel: +44 (0) 20 7775 6653
Email: finance.event@ft.com
www.ftglobalevents.com

12–15: Islamic Finance & Investment World Africa 2007, Johannesburg
Conference to cover Islamic finance trends and developments in Africa and across the globe.
Contact: Brian Shabangu
Tel: +27 11 463 6001
Email: brian.shabangu@terrapinn.co.za
www.terrapinn.com


Johannnesburg

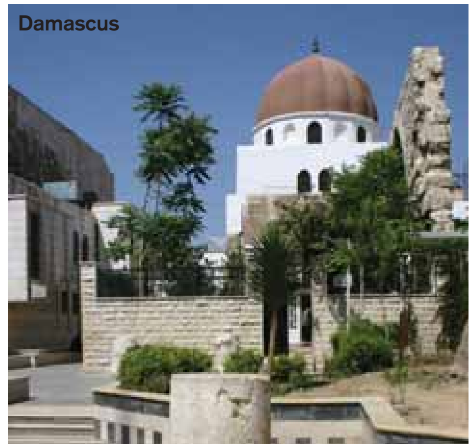
12–15: Islamic Funds World 2007, Dubai
Conference to focus on Shari'ah-compliant funds, capitalisation on the growing Islamic sukuk market and the prospects of further development of the industry; it is also to include the inaugural Master of Islamic Funds Awards ceremony.
Contact: Ms Felicia Sun
Tel: +65 6322 2770
Email: felicia.sun@terrapinn.com
www.terrapinn.com

18: Islamic and Ethical Finance, Dubai
Conference to examine the positioning of the Islamic finance industry, and how to broaden its appeal to socially-aware consumers around the world.
Tel: +971 4362 2438
Email: info@difcweek.ae
www.difcweek.ae

18–19: AAOIFI–World Bank Annual Conference on Islamic Banking and Finance, Bahrain
Conference held by Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) in partnership with the World Bank to focus on standards and characteristics of the industry.
Tel: +973 1724 4496
www.aaoifi.com

19–21: Global Credit & Operational Risk Forum 2007, Singapore
Forum to address critical issues surrounding credit and operational risks, focus on risk integration strategies for the market, and present case study examples from around Asia.
Contact: Ms Tan Peng Pheng
Tel: +603 2723 6614
Email: TanP@marcusevanskl.com
www.marcusevans.com

20–21: International Islamic Finance Congress, Abu Dhabi
Congress to cover various issues of Shari'ah-compliant finance, including retail banking, project finance, sukuk, securities and derivatives.
Contact: Ms Kirsty Churchhouse
Tel: +971 2674 4040 ext 212
Email: kirsty@domeexhibitions.com
www.domeexhibitions.com


Damascus

20–21: The International Financial and Investment Institutions Forum in Syria, Damascus
Forum to promote the Syrian financial sector and its capabilities to attract more capital, including tourist and real estate investments in traditional and Islamic banks.
Tel: +963 11 334 2771
Email: marketing@alsalam.co.sy
www.alsalam.co.sy

21: Hawkamah Conference, Dubai
Conference to promote the development of strong financial markets and banking systems, and address the issues of corporate governance landscape in the MENA region.
Tel: +971 4362 2559
Email: info@hawkamah.org
www.hawkamahconference.org

22–23: 4th Annual Bancassurance, India
Conference to cover the regulatory framework governing bancassurance in India, assess the reasons for entering the bancassurance market, and focus on the effective integration between banks and insurers.
Contact: Ms Kelly Lee
Tel: +603 2723 6798
Email: KellyL@marcusevanskl.com
www.marcusevans.com

IIBI Events endorsed by the IIBI

26–27 November: Asset Liability Management 2007, India
Conference aims to explore the current situation, key drivers, structural issues and latest developments in ALM.
Contact: Ms Kelly Lee
Tel: +603 2723 6798
Email: KellyL@marcusevanskl.com
www.marcusevans.com

27–28: 3rd Seminar on the Regulation of Takaful, Cairo
Seminar hosted by the Egyptian Insurance Supervisory Authority to focus on legal and regulatory challenges of the industry, corporate governance, retakaful and other issues.
Contact: Ms Farrah Aris
Tel: +60 326 984 248 ext 116
Email: farrah@ifsb.org
www.ifsb.org

27–28: National Conference on Islamic Finance (NCiF) 2007, Kuala Terengganu
Conference organised by Universiti Darul Iman Malaysia to focus on contemporary issues pertaining to Islamic finance.
Contact: Dr Izah Mohd Tahir
Tel: +60 9665 3758
Email: izah@udm.edu.my
www.udm.edu.my

December

2–4: 13th Annual International Conference: Arab and Global Banking and Financial Cooperation: Challenges and Prospects, Cairo
Conference to promote and expand Arab–global financial cooperation, and to present the Islamic alternative in each conventional financial activity covered in the conference.
Tel: +962 6550 2900 exts 127, 128, 129
Email: conferences@aabfs.org
www.aabfs.org

5–6: Islamic Financial Services Forum: The European Challenge, Frankfurt
Forum to focus on recent developments and future challenges facing the Islamic finance industry in Europe and across the world.
Contact: Ms Puteri Noorlela
Tel: +60 326 984 248 ext 114
Email: puteri@ifsb.org
www.ifsb.org

5–6: Takaful Conference on Islamic Investment Management, Dubai
Conference to focus on how to get best returns on investment of takaful funds while being Shari'ah-compliant.
Email: conference@asiainsurancereview.com
www.meinsurancereview.com

8–10: The World Islamic Banking Conference, Bahrain
14th annual conference to focus on the key issues and action strategies of the Islamic finance industry across the globe.
Tel: +971 4343 1200
Contact: Ms Anu Thomas
Email: anu@megaevents.net
www.megaevents.net

January 2008

15–16: Seminar on Islamic Finance, Hong Kong
Seminar jointly organised with the Hong Kong Monetary Authority to create awareness of Islamic financial services in Hong Kong.
Contact: Ms Farrah Aris
Tel: +60 326 984 248 ext 116
Email: farrah@ifsb.org
www.ifsb.org

21–22: Islamic Finance Forum, Dubai
Forum to explore the key to success in the Islamic finance industry and to establish where the opportunities lie.
Tel: +971 4221 3452
Email: info@ievents.ae
www.ievents.ae

29–30: Islamovative Finance Asia IQ 2008, Singapore
Conference to focus on the current state of play and future prospects for Islamic finance in Asia and globally.
Tel: +65 672 293 88
Email: enquiry@iqpc.com.sg
www.iqpc.com


Jakarta

31–1 February: 8th CEO Insurance Summit, Jakarta
Summit to focus on conventional insurance and takaful and challenges facing the industry's CEOs.
Tel: +65 6224 5583
Email: conference@asiainsurancereview.com
www.meinsurancereview.com

April 2008

19–20: Eighth Harvard University Forum on Islamic Finance, Cambridge, USA
The theme of the forum is 'Innovation and Authenticity'. It is to focus on the latest innovations and developments in the Islamic finance industry and the long-term impact, scope and authenticity of these ideas in the context of an Islamic community and way of life. Papers are sought in the following areas:
- Debt and debt-based instruments
- Equity and equity-based instruments
- Regulation and supervision
- Beyond traditional financial services

Tel: +1 617 496 2296
Email: ifp@law.harvard.edu
ifp.law.harvard.edu

Events endorsed by the IIBI

arboun
An Islamic version of option, a deposit for the delivery of a specified quantity of a commodity on a pre-determined date.

bai al-ina
This refers to the selling of an asset by the bank to the customer on a deferred payments basis, then buying back the asset at a lower price, and paying the customer in cash terms.

bai bithaman ajil
Sale of goods on a deferred payment basis – credit sale; another term used for such sales is bai muajjal. Equipment or goods requested by the client are bought by the bank which subsequently sells the goods to the client at an agreed price which includes the bank's mark-up (profit).

fatwa
A ruling made by a competent Shari'ah scholar on a particular issue, where fiqh (Islamic jurisprudence) is unclear. It is an opinion, and is not legally binding.

fiqh
Islamic jurisprudence. The science of the Shari'ah. This is an important source of Islamic economics.

gharar
Lit: uncertainty, hazard, chance or risk. Technically, sale of a thing which is not present at hand; or the sale of a thing whose consequence or outcome is not known; or a sale involving risk or hazard in which one does not know whether it will come to be or not.

Hajj
Pilgrimage to Mecca. Hajj is a duty on every Muslim who is financially and physically able to carry it out, at least once in his lifetime. Hajj is performed in the month of Zulhajjah – the last month of the Islamic calendar.

halal
Activities, which are permissible according to Shari'ah.

haram
Activities, which are prohibited according to Shari'ah.

ibaha
Lit: permissibility. Ibaha refers to the rule that every economic transaction is mubah (permissible) unless expressly and specifically forbidden by the Shari'ah.

ijara
A leasing contract under which a bank purchases and leases out a building or equipment or any other facility required by its client for a rental fee. The duration of the lease and rental fees are agreed in advance. Ownership of the equipment remains in the hands of the bank.

ijara wa iqtina
The same as ijara except the business owner is committed to buying the building or equipment or facility at the end of the lease period. Fees previously paid constitute part of the purchase price. It is commonly used for home and commercial equipment financing.

istisna
A contract of acquisition of goods by specification or order, where the price is fixed in advance, but the goods are manufactured and delivered at a later date. Normally, the price is paid progressively in accordance with the progress of the job.

kafalah
Lit: responsibility or suretyship. In kafalah, a third party becomes surety for the payment of debt. It is a covenant/pledge given to a creditor that the debtor will pay the debt or any other liability.

mudarabah
A form of business contract in which one party brings capital and the other personal effort. The proportionate share in profit is determined by mutual agreement at the start. But the loss, if any, is borne only by the owner of the capital, in which case the entrepreneur gets nothing for his labour.

murabaha
A contract of sale between the bank and its client for the sale of goods at a price plus an agreed profit margin for the bank. The contract involves the purchase of goods by the bank which then sells them to the client at an agreed mark-up. Repayment is usually in instalments.

musharakah
An agreement under which the Islamic bank provides funds which are mingled with the funds of the business enterprise and others. All providers of capital are entitled to participate in the management but not necessarily required to do so. The profit is distributed among the partners in predetermined ratios, while the loss is borne by each partner in proportion to his contribution.

qard hasan
An interest-free loan given either for welfare purposes or for fulfilling short-term funding requirements. The borrower is only obligated to pay back the principal amount of the loan.

qimar
Lit: gambling. Technically, an agreement in which possession of a property is contingent upon the occurrence of an uncertain event.

rahan
collateral; technically, it means to pledge or lodge a real or corporeal property of material value as security for a debt or pecuniary obligation so as to make it possible for the creditor to recover the debt, in case of non-payment, by selling the pledged property.

Ramadan
It is the ninth month of Islamic calendar, during which Muslims fast; it is also a time for reflection, intensive prayer and self-restraint.

retakaful
Reinsurance based on Islamic principles. It is a mechanism used by direct insurance companies to protect their retained business by achieving geographic spread and obtaining protection, above certain threshold values, from larger, specialist reinsurance companies and pools.

salam
Salam means a contract in which advance payment is made for goods to be delivered later on.

Shari'ah
Refers to the laws contained in or derived from the Quran and the Sunnah (practice and traditions of the Prophet Muhammad (PBUH).

Shari'ah board
An authority appointed by an Islamic financial institution, which supervises and ensures the Shari'ah compliance of new product development as well as existing operations.

shirkatulmilk
Partnership by ownership, which could be automatic as in the case of inheritance by eg two brothers, or optional such as two persons purchasing a property jointly (not for a commercial purpose).

shirkatulaqd
A contract between two or more persons who launch a business or financial enterprise to make profit. Generally it is termed as 'shirkah'.

sukuk
Similar characteristics to that of a conventional bond with the key difference being that they are asset backed; a sukuk represents proportionate beneficial ownership in the underlying asset. The asset will be leased to the client to yield the return on the sukuk.

tabarru
A donation covenant in which the participants agree to mutually help each other by contributing financially.

takaful
A form of Islamic insurance based on the Quranic principle of mutual assistance (ta'awuni). It provides mutual protection of assets and property and offers joint risk sharing in the event of a loss by one of its members.

tawaruq
A sale of a commodity to the customer by a bank on deferred payment at cost plus profit. The customer then sells the commodities to a third party on spot basis and gets instant cash.

Umra
Lit: visiting or attending. It is a mini-pilgrimage to Mecca which is not compulsory, but highly recommended, and can be performed at any time of the year.

wa'ad
A promise to buy or sell certain goods in a certain quantity at a certain time in future at a certain price. It is not a legally binding agreement.

wakala
A contract of agency in which one person appoints someone else to perform a certain task on his behalf, usually against a certain fee.

waqf
An appropriation or tying-up of a property in perpetuity so that no propriety rights can be exercised over the usufruct. The waqf property can neither be sold nor inherited nor donated to anyone.

zakat
An obligation on Muslims to pay a prescribed percentage of their wealth to specified categories in the society, when their wealth exceeds a certain limit. Zakat purifies wealth. The objective is to take away a part of the wealth of the well-to-do and to distribute it among the poor and the needy.

Fueling Indonesia's progress is an Amanah.

For years, HSBC Amanah has been helping to provide customers worldwide with Islamic alternatives to conventional financing; from funding oil refineries in Indonesia to transportation services for Hajj pilgrims in Saudi Arabia.

With offices around the world, HSBC Amanah has worked together with leading Islamic financial institutions such as the Islamic Development Bank to develop pioneering Shariah-compliant financial solutions. Be it sponsoring the Islamic Finance project at Harvard University, or financing gas tankers in Brunei, or the Hamad Health City in Qatar, HSBC Amanah has been privileged to be a part of the development of the Islamic Finance industry.

Part of one of the world's largest financial services organizations, HSBC Amanah is uniquely positioned to provide a comprehensive range of Islamic financial solutions. Behind each solution lies a dedicated team of highly qualified professionals and a Shariah Supervisory Committee comprised of world-renowned Islamic scholars.

With HSBC Amanah, helping finance some of the most prominent projects around the world in accordance to the principles of Shariah isn't just a privilege, it's an Amanah.

www.hsbcamanah.com

HSBC Amanah

Islamic Financial Solutions