

Islamic Finance in Kenya: Milestones, achievements and Challenges

BY
MR. JUSTUS N. AGOTI
MANAGER, PRODUCT DEVELOPMENT & UPTAKE

April 14, 2023



CONTENT



☐ INTRODUCTION

- Importance of Islamic finance in Kenya
- Current market status

☐ ISLAMIC FINANCE (KENYA) MILESTONES

☐ ACHIEVEMENTS

☐ MARKET CHALLENGES FOR KENYA

☐ PENDING ACTIVITIES

☐ BEING SOUGHT

☐ OUTLOOK

☐ Q&A





INTRODUCTION 1/2

Importance of Islamic Finance in Kenya

- i. Enable Islamic finance to play **an active role** in Kenya's **economic development** and be an enabler for achieving the national goals (Vision 2030).
- ii. **Improve financial inclusion**, regardless of faith or background
- iii. **Improve financial sector and deepening** by way of diversification
- iv. **Increase foreign direct investments** and diversifying sources of funding for infrastructure projects
- v. **Build and enhance economic relationships** with trade partners (GCC?)
- vi. **Position the country** to play an active role in Islamic finance in preparation for financial hub status



INTRODUCTION 2/2

Current market status in Kenya

- Several Islamic Finance institutions operating in IF:
 - 3 fully-fledged Islamic banks, 3rd currently being authorised
 - 5 Shariah windows of conventional banks
 - 1 Takaful company
 - 1 Re-takaful window
 - 1 Shariah Compliant Mutual Fund
 - 2 Shariah Compliant cooperatives
 - Minimal regulation for Islamic finance
 - No screened investible stocks
 - No Sukuk issued to date
 - Market already has experienced the risk exposure through one 'near failure'
-
- **Kenya Vision 2030** - establishing Kenya as a middle middle-income country
 - **Capital Markets Master Plan** – The Heart of African Capital Markets
 - **Nairobi International Finance Centre (NIFC)** – Competitive Intl. Financial Centre on the African Continent
 - The **Bottom-Up Economic Transformation (BeTA)** model





ISLAMIC FINANCE PROJECT - MILESTONES

- **FY 2015/16** Financial Sector Regulators (**CMA, CBK, RBA, IRA & SASRA**) agree to adopt Islamic Finance.
- **October 2015**, with the blessings of the National Treasury and the support of FSD Africa, the Islamic Finance Project Management Office (PMO) **is established**.
- **PMO membership** - secondees from the Financial Sector regulators, Islamic Finance Advisory & Assurance Services (IFAAS) & Simmons & Simmons - housed at the CMA Offices.
- **October 14 2016**, PMO officially launched, with the National Treasury taking the lead in coordinating PMO activities
- After an initial feasibility study, to implement the study findings, a **two-stage** approach towards the regulatory and policy amendments:
 - ❖ The **first stage** through express policy statements to:





ISLAMIC FINANCE PROJECT - MILESTONES

- Recognize Islamic / Participatory Finance as an Alternative Mode of Finance;
 - Provide high-level definitions in the relevant Acts;
 - Confer powers to the Cabinet Secretary to make new regulations for each sub-sector, in consultation with the relevant regulatory authorities; and
 - Include provisions in the law to enact changes as and where required.
 - Propose a Shariah governance structure for Kenya (pending)
- ❖ The **second stage** - proposals on high-level changes to the Acts and Regulations concluded.
- **October 14 2016**, two Key Governance Committees (the Islamic Finance Steering Committee (IFSC) – the Apex Committee composed of Financial Sector Regulators or their nominated representatives and Chaired by C.S. National Treasury and the Islamic Finance Consultative Committee (IFCC) – composed of market stakeholder representatives and the National Treasury and Chaired by the National Treasury also launched (**however, they have not been operationalized as yet**)
 - ❖ The **third stage** – over-arching comprehensive National Policy on Islamic Finance (pending)





ISLAMIC FINANCE KENYA MILESTONES 1/3

Date	IF Activity
4 th – 6 th April 2017	PMO represents Kenya at the 2nd Sub-Saharan Africa Islamic Finance convention held in Kampala, Uganda and the IFSB AGM in Kuala Lumpur, Malaysia hosted by Bank Negara, Malaysia;
10 th - 11 th April 2017	2 participants each from the Financial Sector Regulators attend the 2nd East Africa Economic Summit held at Villa Rosa Kempinski Hotel, Nairobi;
12 th July 2017	One-on-One media briefing done with the Business Daily by the <u>Project Management Office</u> (PMO) for Islamic Finance.
17 th - 18 th July 2017	Training on Sukuk held in Naivasha
16 th - 17 th August 2017	CMA, <u>CBK</u> and National Treasury & Planning representatives attend the 11th <u>IFSB</u> International Centre for Education in Islamic Finance (<u>INCEIF</u>) Executive Forum held in Kuala Lumpur, Malaysia;
14 th to 16 th May 2018	Kenya through CMA hosts the Islamic Financial Services Board (<u>IFSB</u>) Regional Workshop, as part of capacity building on Facilitation of the Implementation of the IFSB Standards (<u>FIS</u>) workshop series.
15 th November 2018	Through the National Treasury & Planning, Kenya hosts a workshop on sub-sectoral White Papers for the financial sector, in preparation for the drafting of a harmonized Financial Sector National Islamic/Participatory Finance Policy document for Kenya.





ISLAMIC FINANCE KENYA MILESTONES – 2/3

Date	IF Activity
25 th September, 2020	A Corporate Sukuk webinar facilitated by Abraar consulting aimed at reviewing Kenya's readiness to issue Corporate Sukuk is held.
30 th October 2020	The Authority hosts a Webinar for NSE and CMA staff on Sukuk and their issuance, facilitated by Mr. Nathif Jama Adam (IFAAS).
4 th December 2020	The Authority holds a half-day Webinar for financial sector regulators and key industry stakeholders on Sukuk and their issuance, as facilitated by Mr. Nathif Jama Adam (IFAAS).
2021	Stakeholder sessions are held on Islamic Finance in Collaboration with IFSB and GCR Ratings





ACHIEVEMENTS

- In the 2017/18 budget statement, the then C.S. National Treasury made policy pronouncements to allow for amendments to the relevant Financial Sector Acts to facilitate operationalization of Islamic Finance

Policy pronouncement	Consequence
<ul style="list-style-type: none"> • Amendments to the Capital Markets Act, the Cooperatives Societies Act and Sacco Societies Act to facilitate for Shariah compliant finance products. • Amendments to the Public Finance Management Act to provide for issuance of Sukuk • Amendments to the tax statutes to provide for equivalent tax treatment of these new financial products with the conventional financial products. • Regulations to facilitate development of Takaful Retirement Benefits Schemes in Kenya. 	<ul style="list-style-type: none"> • Provided a framework for introduction of Islamic products across the financial sector hence deepening the market by providing alternative investment opportunities for investors and also helping position Kenya as a regional hub for Islamic Finance and contributing to the Vision 2030 objective of making Nairobi an International Financial Centre • Amendment of the PFM Act paved the way for issuance of Sukuk as an alternative source of financing for government to finance development projects. • The amendment of tax law improved attractiveness of Islamic products in Kenya by providing for equivalent tax treatment of these new financial products with conventional financial products

MAIN MARKET CHALLENGES 1/2

Regulation (partially addressed)

- Inadequate existing legal, regulatory, taxation, disclosure & supervisory frameworks
- Challenges on asset ownership, transfer and permissible investments
- Disclosure requirements

Technical Capacity

- Product development
- IT systems
- Shariah compliance
- Audit (Shariah and financial)

Awareness

- Limited knowledge in Shariah finance (Regulators, Practitioners, Islamic scholars and consumers);
- Discussions over Shariah compliance of Islamic windows
- Lack of differentiation between Shariah & conventional products

Shariah Governance

- Absence of a uniform framework for Shariah compliance
- Absence of “Fit & Proper” criteria for the scholars
- Lack of financial expertise among the local Shariah scholars



MAIN MARKET CHALLENGES 2/2

Human Capital

- Insufficient number of adequately trained human capital
- Insufficient academic and professional development frameworks for human capital

Process

- Shariah compliance throughout the product/transaction life cycle
- Higher documentation threshold
- Time consuming

Perception

- Political opposition to Islamic law
- Advocacy for change of terminology
- Risk of Islamization
- Links to terror

Costs & Cost of Compliance

- Contract design and documentation
- Additional institutions
- Sovereign Sukuk issuance in US Dollars and/or the Kenya Shilling to serve different objectives

Arbitrage

- Taking advantage of differing market conditions in two markets to make a return on investment.





SOME OF THE PENDING ACTIVITIES

1. Relevant comprehensive amendments to the Banking and Microfinance Acts to facilitate operation of Islamic Finance and issuance of Sukuk
2. Discussions to agree on the appropriate Shariah Governance model for Kenya
3. More capacity building and awareness creation
4. Establishment of a legal framework for Sukuk issuance
5. Development of a clear legal framework for SPVs underpinning the issuance of Sukuk in relation to their establishment, management and accounting treatments
6. Development of Islamic liquidity management solutions within the market





BEING SOUGHT

1. A jump-starting of the process of harmonizing the policy approach that would lead to a comprehensive legal & regulatory framework for issuance of instruments.
2. A more active stakeholder community advocating for and participating in issuances and their uptake.





OUTLOOK

- The future for Islamic Finance and Islamic Capital Markets looks bright.
- More collaboration among key stakeholders will be required and is anticipated.



THANK YOU!

