



# GIFF IFN Asia Forum 2010

## Islamic Finance Industry: 2010 & Beyond

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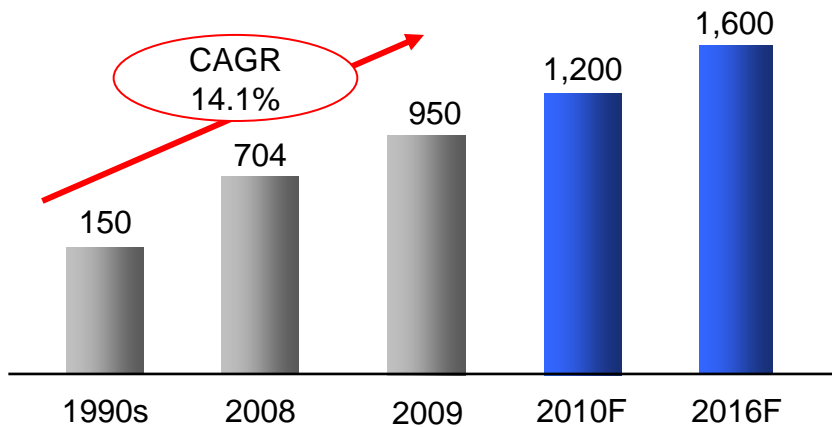
# CONTENT

- **Overview of the Islamic Finance Industry**
- **Opportunities & Challenges**

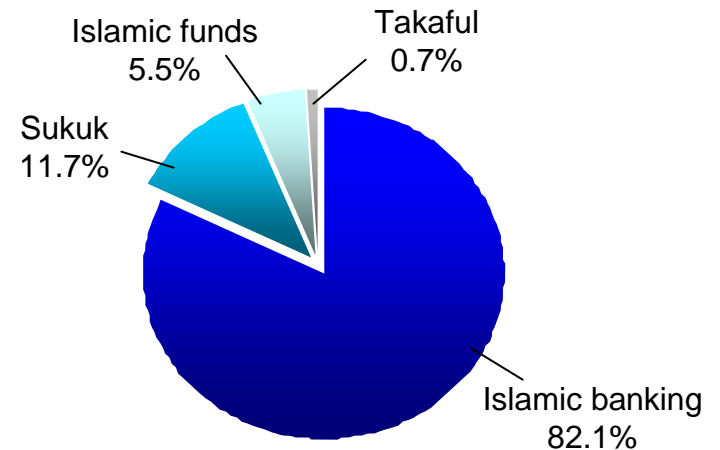
# ISLAMIC FINANCE: WHERE WE ARE

- Islamic assets have expanded at a CAGR of **14.1%** from USD150bln in the mid-1990s to USD1.0tln in 2009
- The industry has demonstrated its competitiveness and resilience during the global financial crisis period. Post crisis, apart from Muslim countries, Islamic finance is making headways into new jurisdictions
- Efforts are being focused on the further development of Islamic financial markets, its infrastructure and enhancing the legal, regulatory and supervisory framework
- As at end-2009, Islamic banking assets represented 82.1% of overall Islamic assets followed by Sukuks (11.7%) and Islamic funds (5.5%)
- The IFSB expects the global Islamic finance assets to reach **USD1.6tln by 2012**

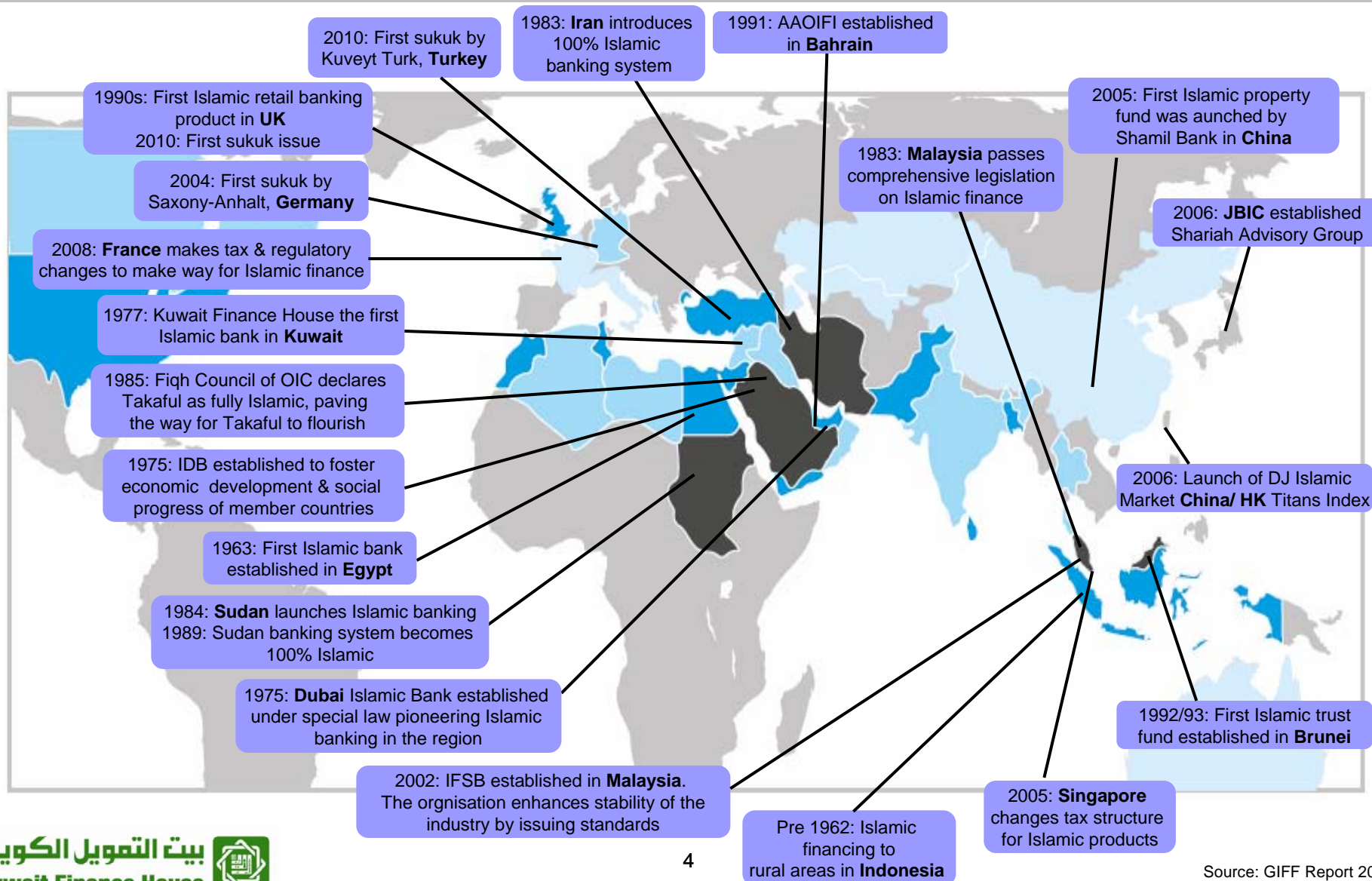
Islamic Finance Assets Trend, USD bln (1990s-2012F)



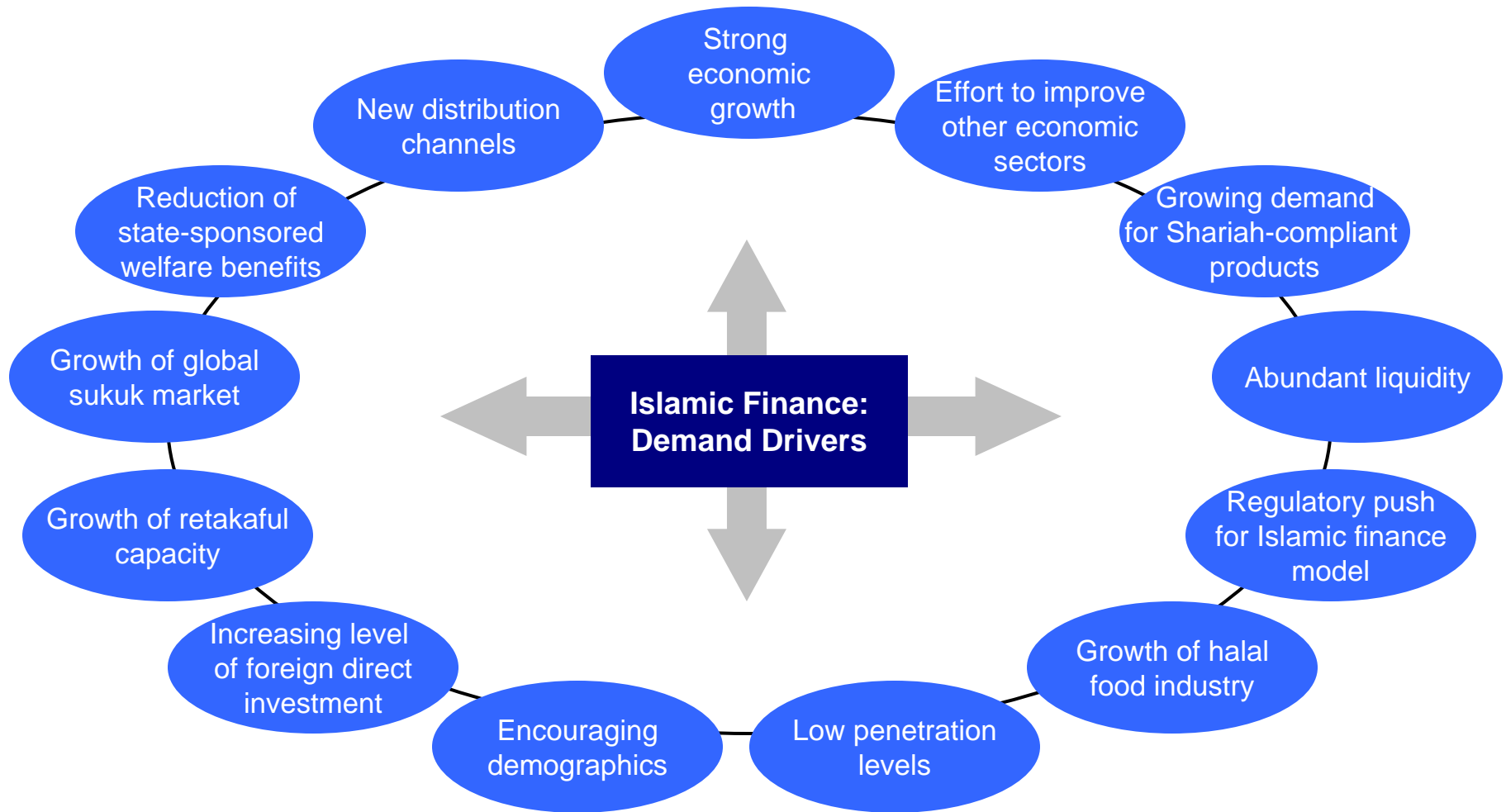
Breakdown of Islamic Assets (2009)



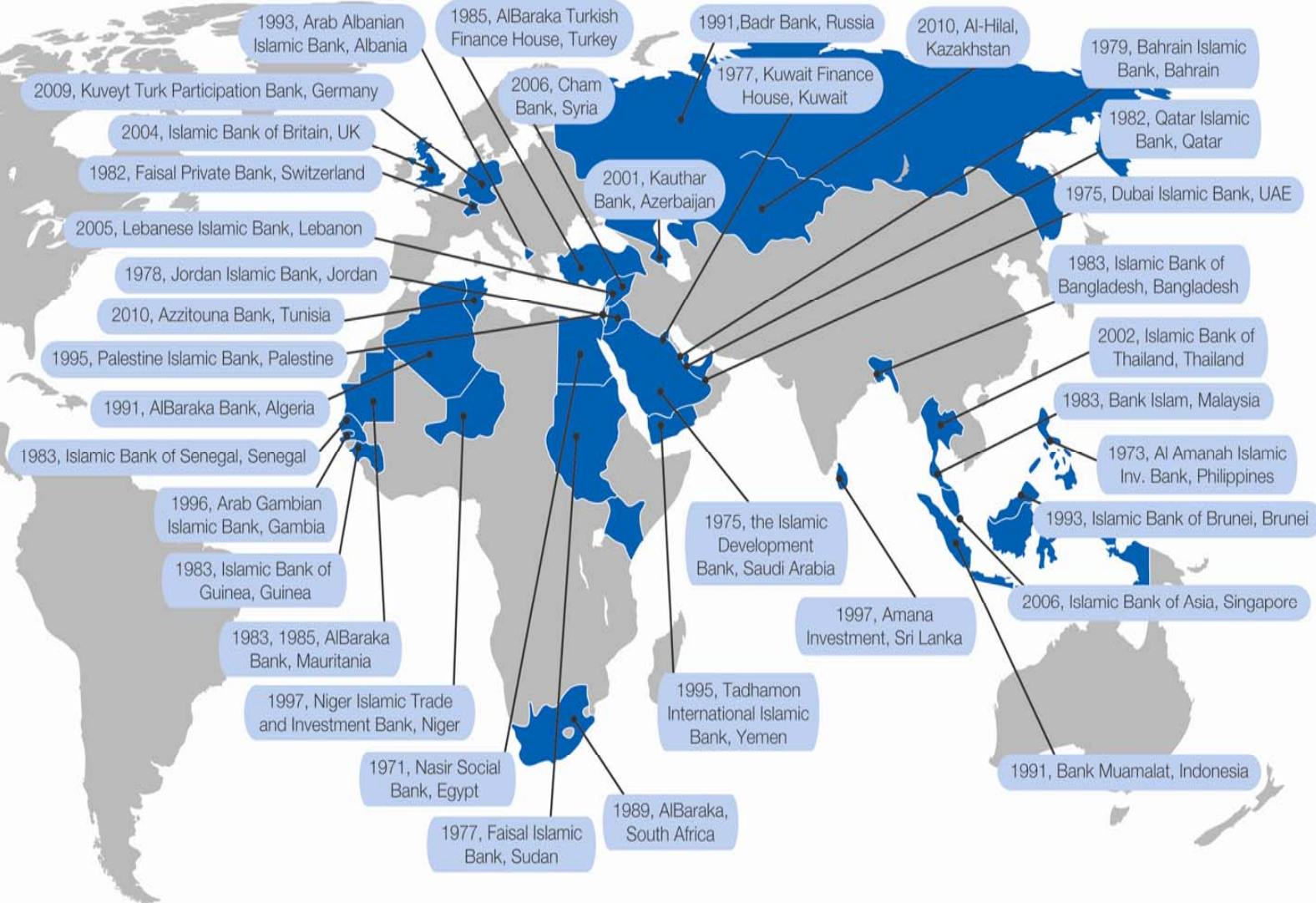
# A GLOBAL INDUSTRY



# FACTORS FUELLING GROWTH OF ISLAMIC FINANCE

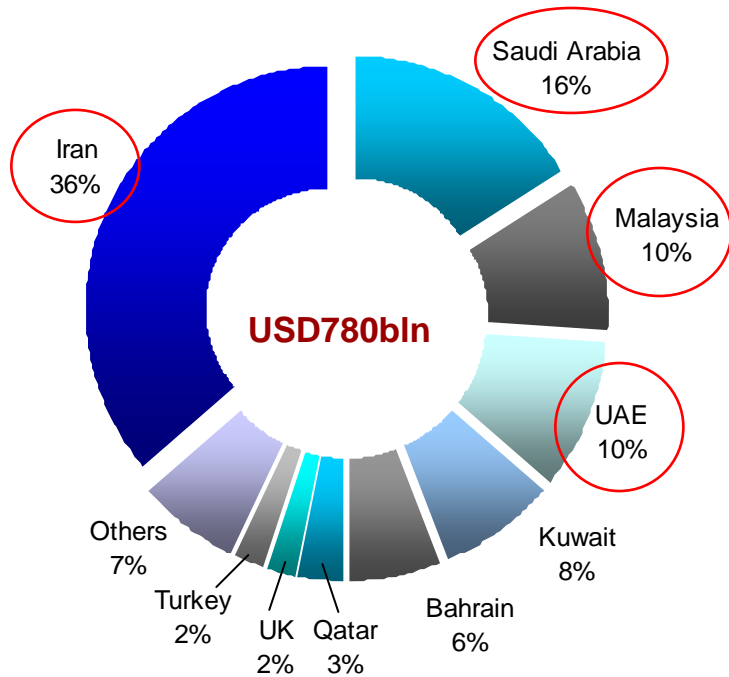


# ISLAMIC BANKS TODAY...



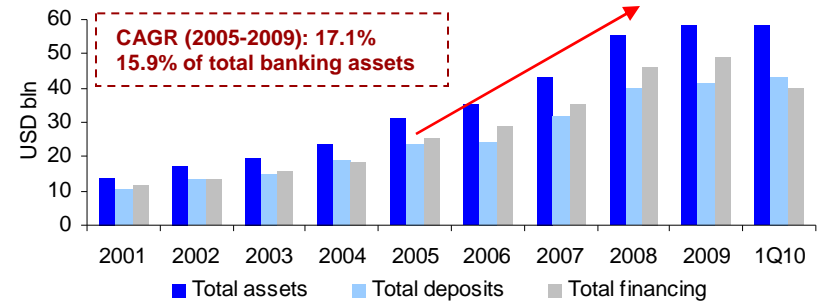
# GLOBAL ISLAMIC BANKING INDUSTRY

Share of Global Islamic Banking Assets (2009)

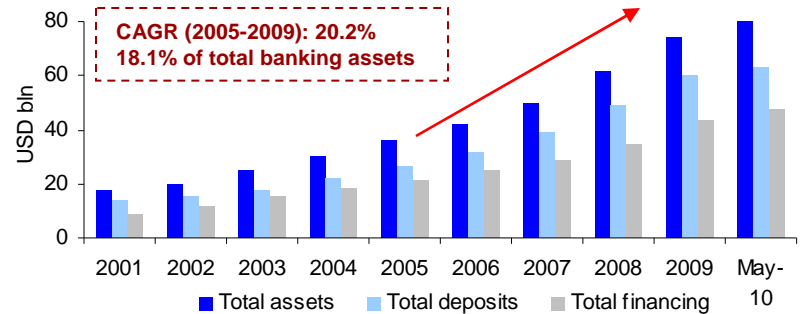


➤ Islamic banks' market shares are currently 10% in Malaysia and 43% in the GCC. Iran has the largest market share at 36%

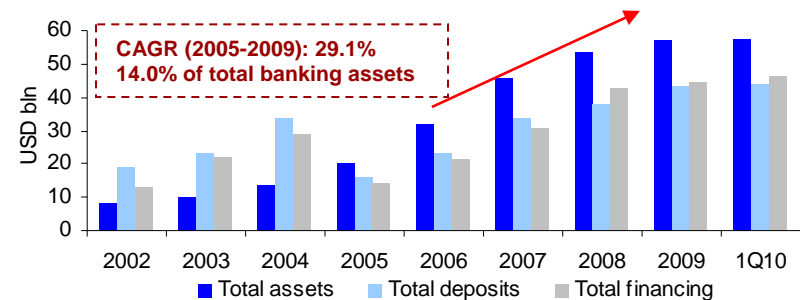
Islamic Banking: Saudi Arabia



Islamic Banking: Malaysia



Islamic Banking: UAE

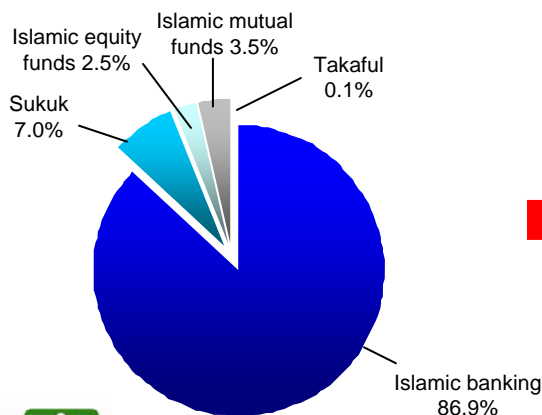


# ISLAMIC BANKS RESILIENT DURING CRISIS

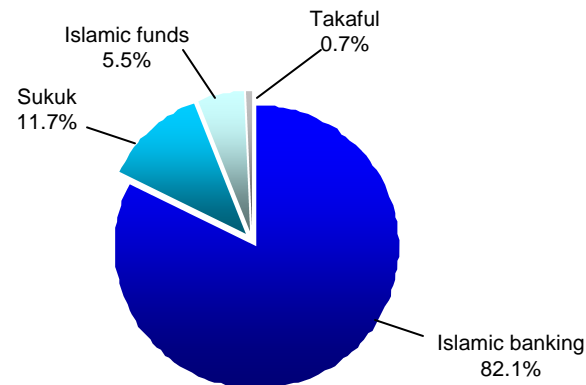
- In April 2010, the Islamic Finance and Global Financial Stability Report stated that only 1 Islamic financial institution required government assistance to restructure as a result of the global financial crisis
- In contrast, 5 of the world's top conventional banks received government assistance amounting to USD163bln or 26% of their combined equity
- As at end-2009, not a single Islamic bank required any rescue scheme from their respective governments
- The main factors that have contributed towards the resiliency of Islamic banks during the crisis include:
  - ✓ **Domestic credit portfolios.** Credit portfolios have been essentially domestic rather than foreign, with limited pressure on asset quality
  - ✓ **Retail banking focused.** High consumer loyalty and deposit stability limit the profitability of massive bank runs
  - ✓ **High capitalisation** and ample liquidity provide a relatively higher amount of confidence to counterparts

Breakdown of Shariah Compliant Assets Worldwide

2003



2009



# GLOBAL ISLAMIC BANKING

## Islamic Banks Post-Crisis: To Remain Resilient

The board of directors and senior management to have in place high standards of corporate governance

Islamic banks to further strengthen the risk management systems



Islamic banks to avoid concentrating too many assets in specific sectors

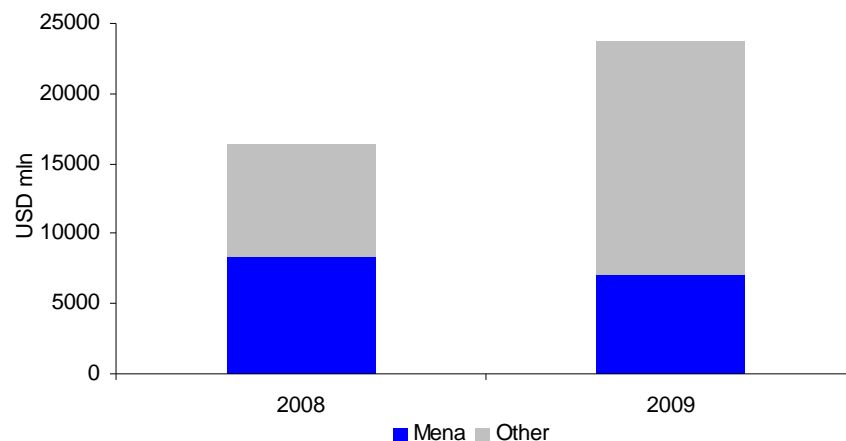
Shariah supervisory board to ensure that new products are Shariah-compliant

# GLOBAL SUKUK MARKET

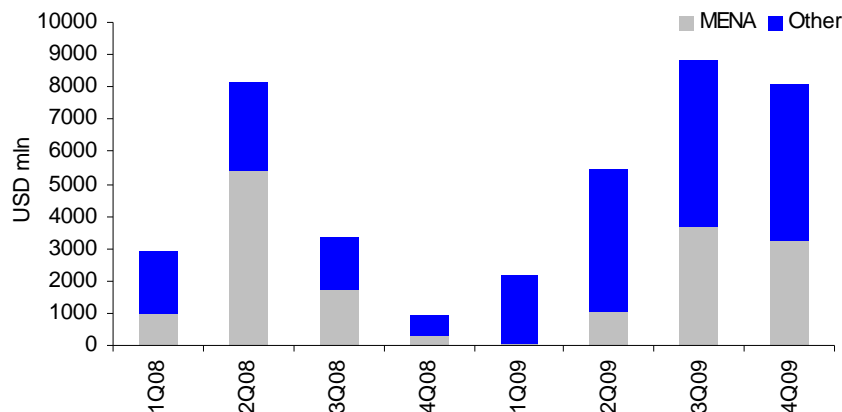
Sukuk Issued by Selected Countries  
USDmIn (2007-1H10)

Country	1H10	2009	2008	2007
Malaysia	9,919.0	13,306.1	5,470.4	13,412.9
UAE	-	3,338.8	5,300.2	10,807.5
Saudi Arabia	2,317.0	3,117.9	1,873.2	5,716.3
Bahrain	350.0	1,743.1	700.4	1,065.0
Indonesia	2,329.8	1,571.2	663.3	92.8
Pakistan	-	589.2	476.2	524.3
Qatar	13,74.0	392.8	300.9	300.0
Kuwait	-	98.2	190.0	835.0
Brunei	63.0	24.6	95.1	279.3

Sukuk Issued by Region (2008-2009)



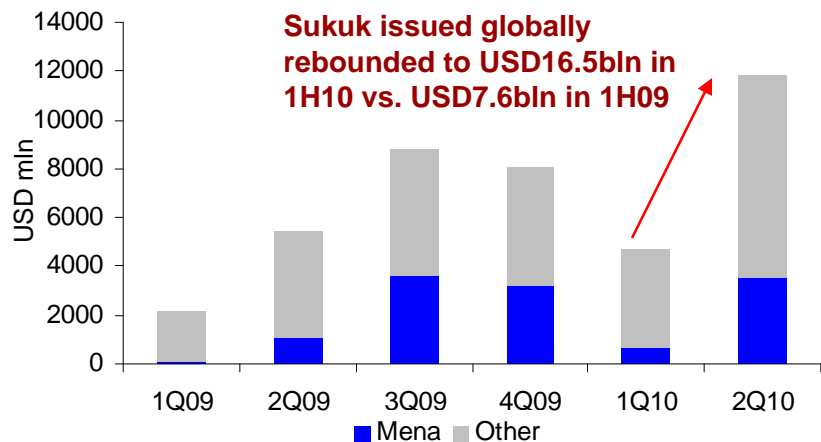
Sukuk Issued Quarterly (2008-2009)



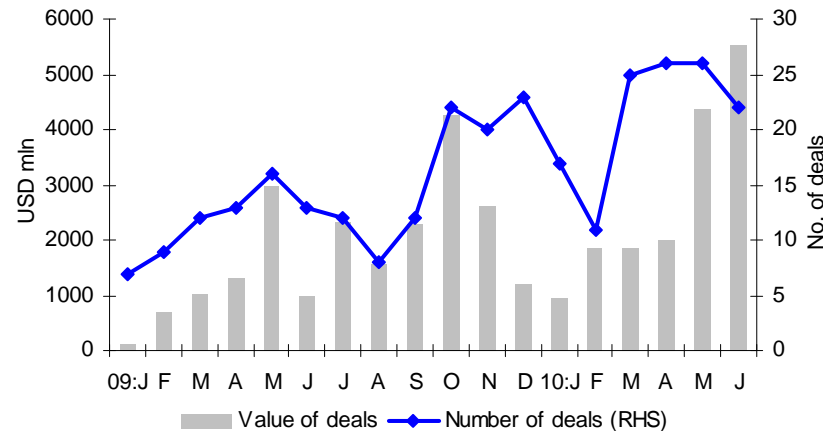
- In 2009, global sukuk issuance rebounded by 59% yoy **USD24.55bln**
- Malaysia dominated with 54.2% of total new issuances. The UAE and Saudi Arabia trailed at 13.6% and 12.7% respectively
- Sovereign papers led the way, at 53.8% of new issues, followed by power & utilities at 11.2% and financial services at 9.7%
- Expect 2010 sukuk issuance to come in at a decent **USD30bln**

# GLOBAL SUKUK MARKET 1H10

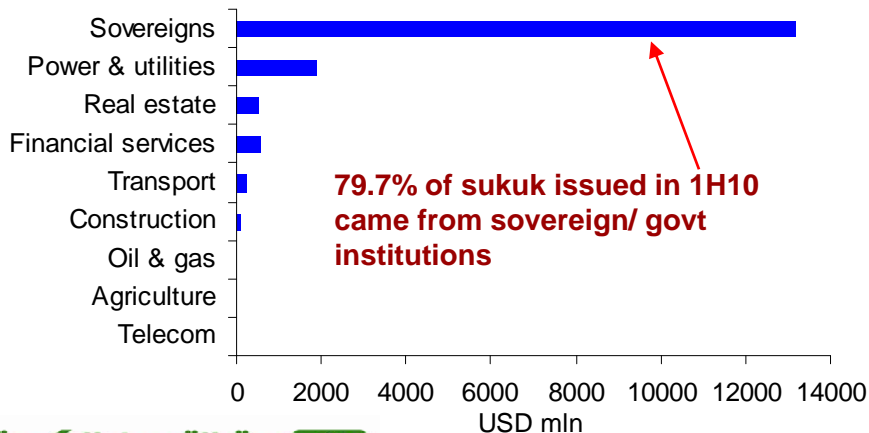
Global Sukuk Issued Quarterly Trend (2009-1H10)



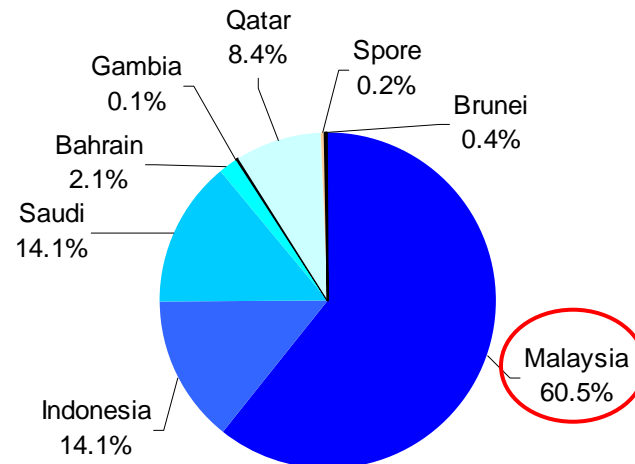
Global Sukuk Issued Monthly (2009-1H10)



Global Sukuk Issued by Sector (1H10)

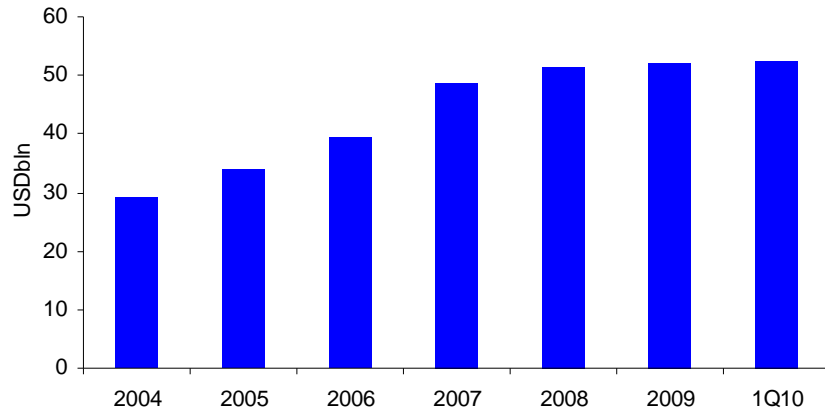


Global Sukuk Issued by Country (1H10)

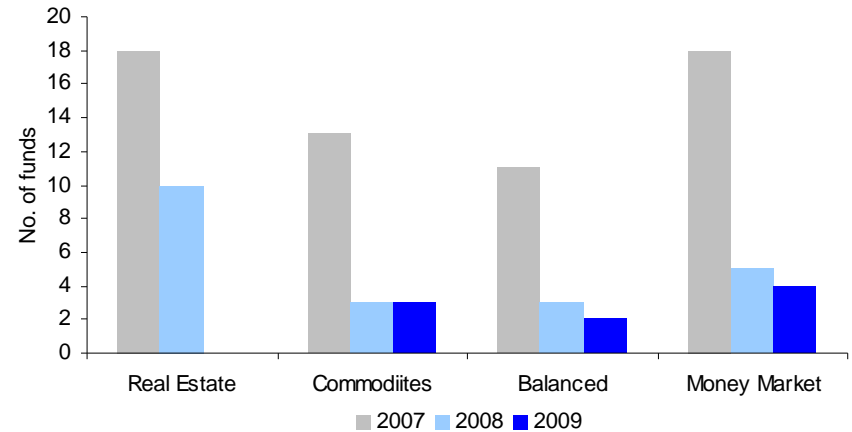


# GLOBAL ISLAMIC FUNDS

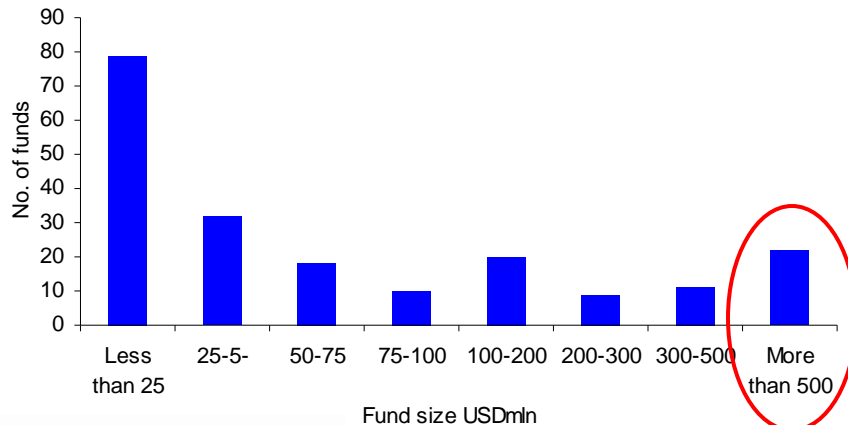
Islamic Funds AuM in USD bln (2004-1Q10)



Number of Islamic Funds Launched by Asset Class (1Q10)



Number of Islamic Funds by Size (1Q10)

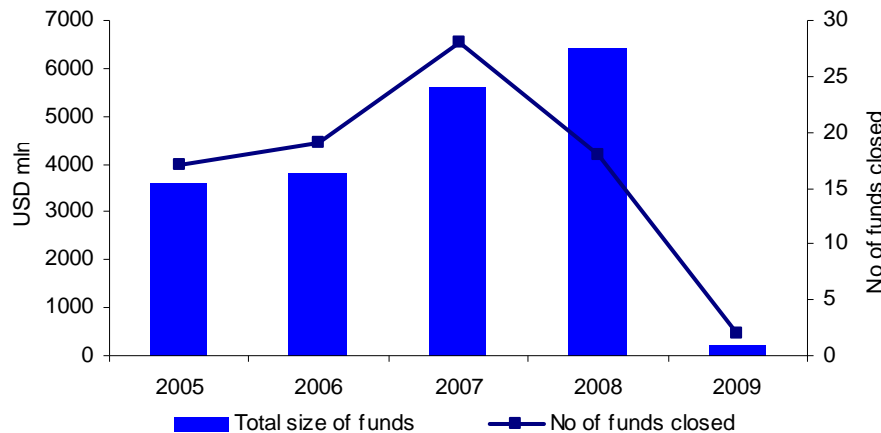


- As at end-2009, Islamic fund assets totaled USD52.3bln, almost the same level of USD51.4bln posted in 2008
- Islamic funds industry is still at early stages of growth. Over 70% of Islamic fund size is <USD100mln. Only less than 10% of Islamic fund size is >USD500mln
- Post crisis, Islamic funds invest mainly in commodities and money market
- At a conservative annual growth of 6% for 2009-2013, the value of global Islamic assets under management may reach **USD66bln in 2013**

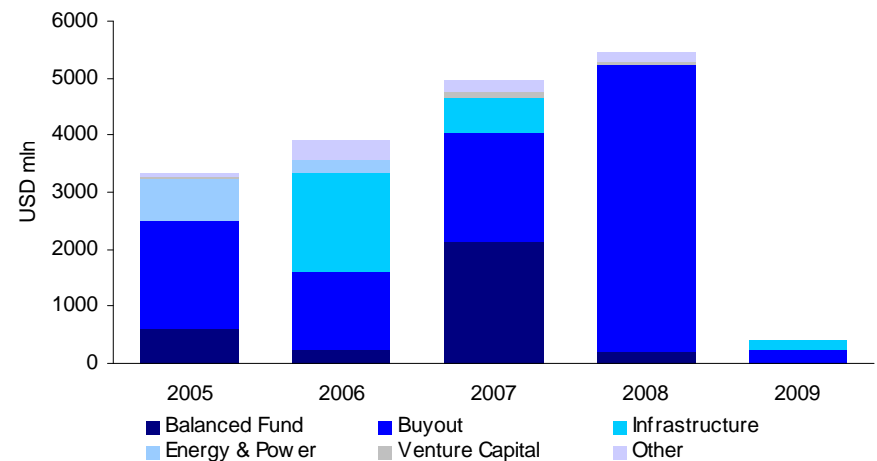
# ISLAMIC PRIVATE EQUITY

- In 2009, private equity activity in MENA is almost at stand still due to very limited availability of new investments in the region. The average fund size value in 2009 decreased to USD200mln compared to USD6.4bln in the previous year
- Infrastructure fund is the favourite sector for investment due to the large demand for infrastructure financing in the MENA region. Government bodies in the region allocate excess funds from oil revenue to be invested into infrastructure development projects and funds
- Private equity investment promotes the key principle of Islamic investment i.e. investments into productive economic activities
- Islamic private equity industry is expected to reach **USD40bln by 2011**. Even at USD40bln, Islamic private equity commands a minute portion of the global Islamic assets

Breakdown of Private Equity Fundraising in MENA (2005-2009)



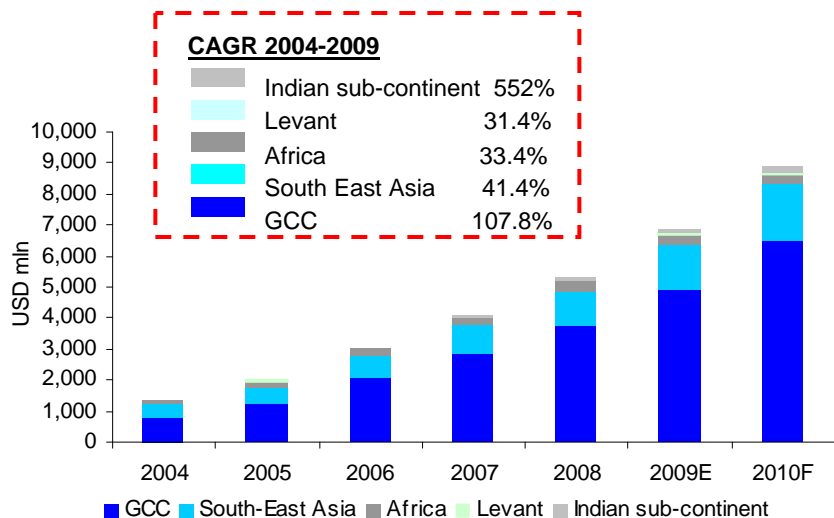
Breakdown of Funds Raised by Sector (2005-2009)



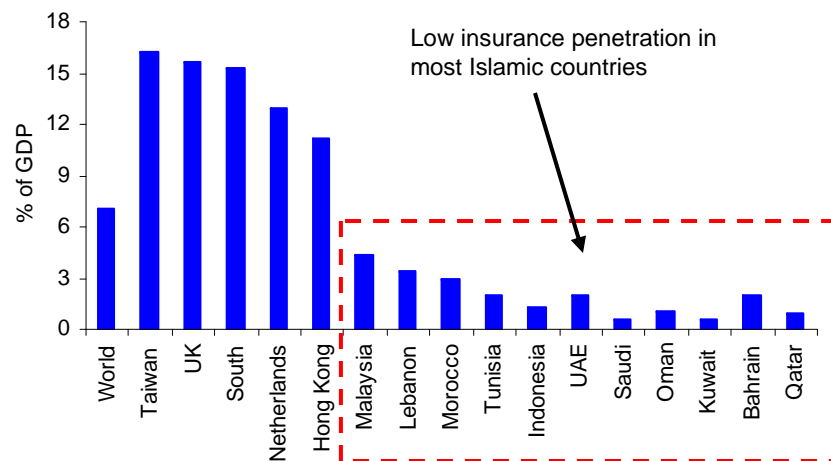
# GLOBAL TAKAFUL

- Global gross Takaful contributions continue to post healthy growth, reaching USD5.3bln in 2008 and estimated at **USD6.9bln in 2009**
- Takaful contributions by region – GCC 70.4% (Saudi 54.8%, UAE 10.2%) , South East Asia 21.5% (Malaysia 16.7%, Indonesia 3.5%), Others 8.1% (Sudan 5.3%)
- Potential of the Takaful industry is enormous. Insurance penetration in most Islamic countries is low at 1.4% of GDP vs. global average 7.1%, UK 12.4%, US 9.4% and emerging markets 2.8%
- Strong fundamentals suggest global contributions could reach **USD8.9bln by 2010**

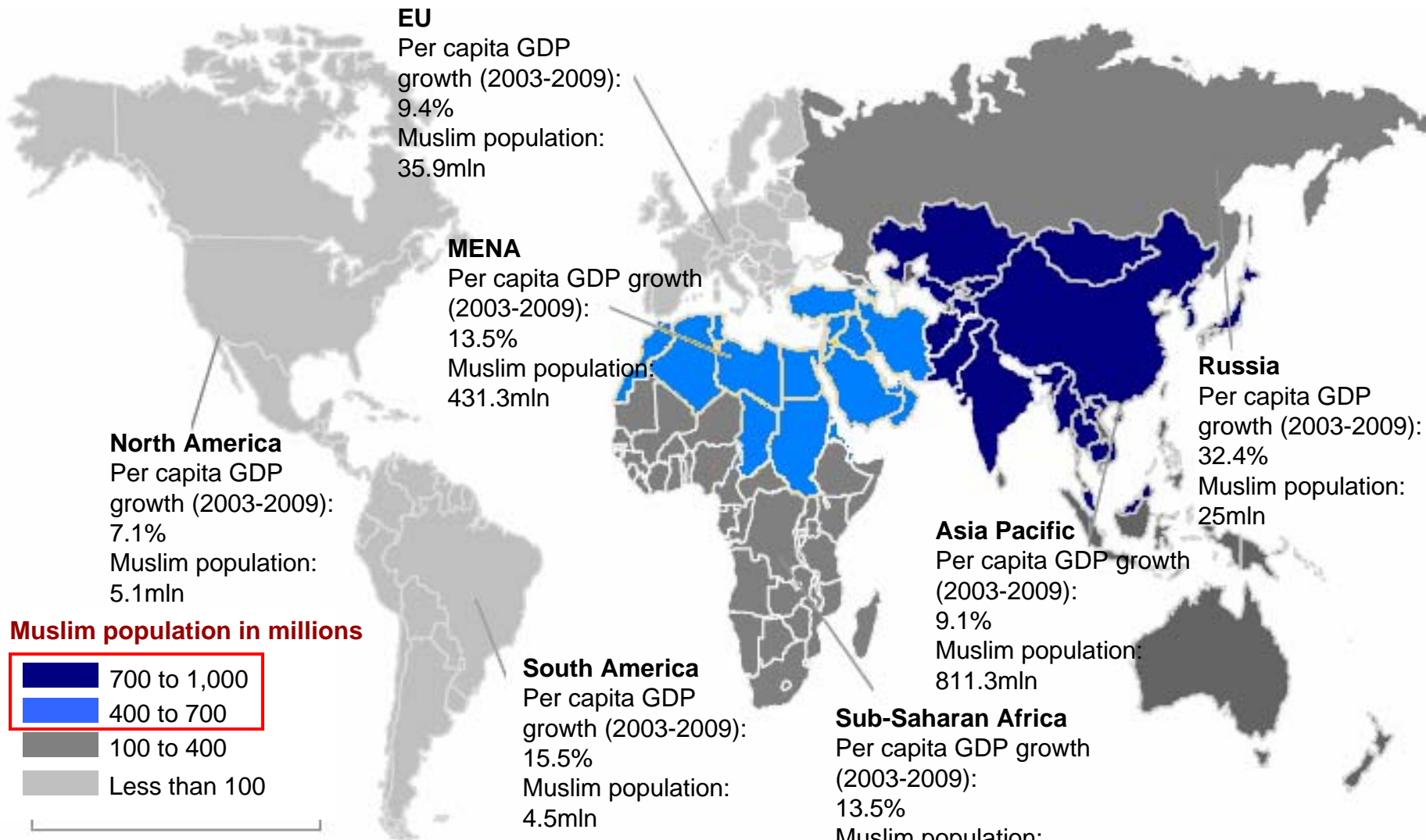
Global Gross Takaful Contributions (2004-2010F)



Written Life & Non-Life Premiums as a % of GDP (2008)

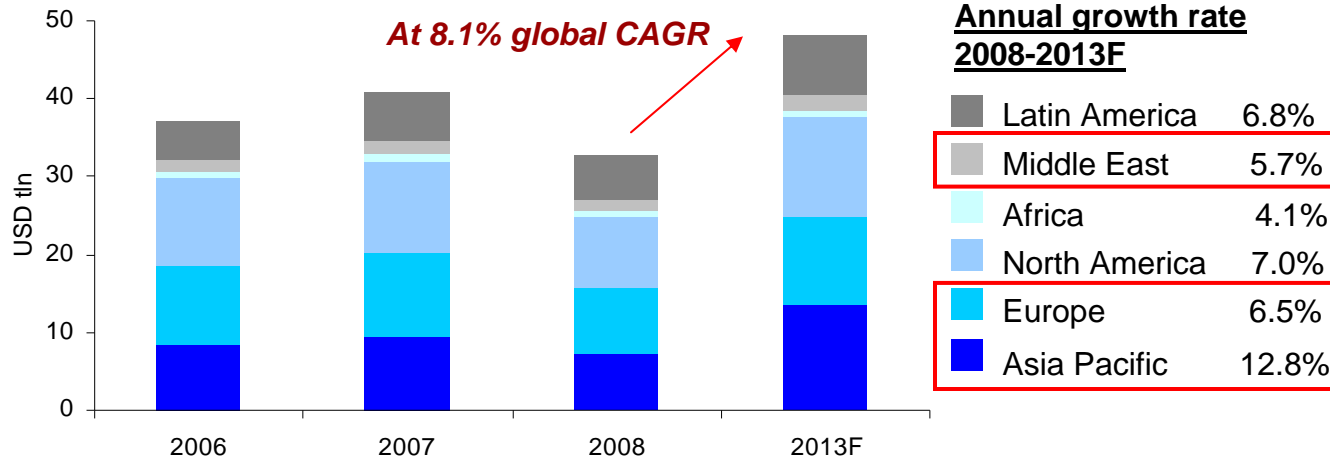


# OPPORTUNITIES FOR ISLAMIC FINANCE: HIGH MUSLIM POPULATION IN ASIA, MIDDLE EAST & EU



# OPPORTUNITIES FOR ISLAMIC FINANCE: RISING GLOBAL WEALTH

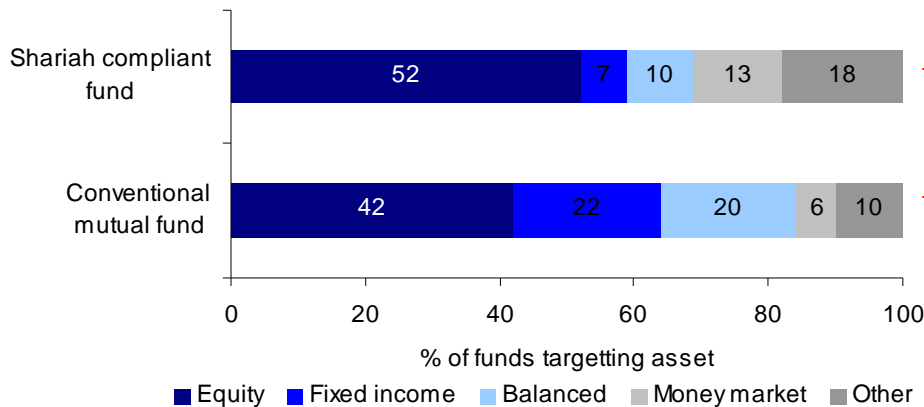
Global HNWI's Wealth by Region (2006-2013F)



Global HNWI's wealth is projected to grow at a CAGR of 8.1% for 2008-2013F, from USD32.8tn in 08 to **USD48.5tn in 2013**

Asia Pacific and the Middle East seeing the biggest increase in wealth

Composition of Investment Funds by Assets Classes



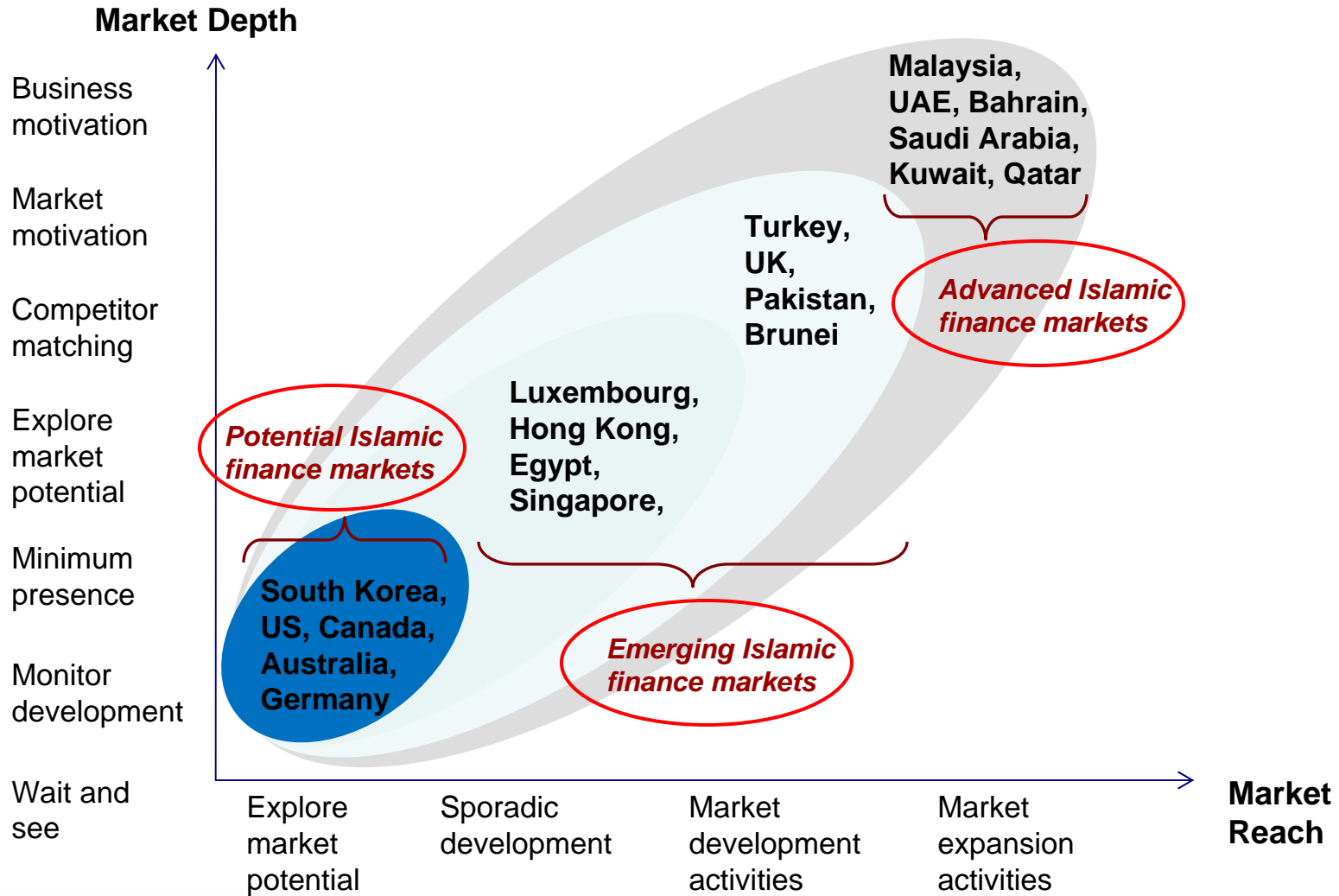
→ Shariah compliant investment funds essentially target equities and money market instruments

→ While conventional funds present a more balanced and fixed income oriented asset allocation

# CONTENT

- Overview of the Islamic Finance Industry
- Opportunities & Challenges

# ISLAMIC FINANCE MARKETS



# REGULATORY INITIATIVES IN NEW MARKETS

## Thailand

- The Thai cabinet approved in principle a draft ministerial regulation to allow the issuance of Islamic bonds in Thailand
- The amendment will expand the boundary of securities transactions to allow brokering, trading and arranging the issuance of sukuk

## Jordan

- The government has recently formed a committee to study mechanisms of issuing sukuk including financial, legal and technical matters

## Kazakhstan

- The government established a working group in 2009 to draw up a roadmap for an Islamic financial system
- Principles of Islamic finance were introduced in the Kazakh legislation to facilitate various Islamic financial transactions

## African countries

- The Central Bank of Nigeria introduced the Law Governing the Operation of Islamic Banks in 2009, bringing the authorisation of Islamic financial institutions on par with the same provisions relating to conventional banks
- Kenya authorised two Islamic banks following the introduction of an Islamic banking law

## France

- The latest European country to emulate the UK in overhauling its tax laws to facilitate Islamic financial transactions
- In July 10, the country passed new instructions to facilitate the introduction of sukuk, Ijarah, Murabahah and Istisna products (previously only sukuk and Murabahah)

# GROWTH AREA: ISLAMIC FINANCING FOR SMEs

<b>Facts</b>	<ul style="list-style-type: none"> <li>▪ In emerging countries, banks have largely focused on the profitable corporate business</li> <li>▪ Although <b>SMEs account for up to 90% of some emerging countries business</b> and represent the lifeblood of local trade, FIs have generally ignored this sector due to the following reasons:             <ul style="list-style-type: none"> <li>✓ Non-transparent information</li> <li>✓ SMEs being small and often undercapitalised, being perceived as high risk due to inadequate collateral</li> <li>✓ Weak financials result in a weaker credit profile</li> <li>✓ SMEs are not considered profitable as there are higher cost to serve them owing to transactions being small and numerous</li> </ul> </li> </ul>
<b>Opportunities</b>	<ul style="list-style-type: none"> <li>▪ A CGAP (a unit under the World Bank) market survey of 125 institutions in 19 Muslim countries, Islamic microfinance providers reach only 300,000 clients in Bangladesh and 80,000 clients in Indonesia</li> <li>▪ Thus, SME market offers huge opportunity of growth given the still largely unserved market. It will provide Islamic FIs with portfolio diversification, opportunities to cross sell products and it becomes a source of stable income</li> </ul>
<b>Rationale</b>	<ul style="list-style-type: none"> <li>▪ Also, Islamic finance stresses the importance of <b>financing real, tangible economic activity</b> and this focus on real assets fits very well with the goals of microfinance</li> <li>▪ If the underlying asset has durable value and the business is viable, the current income of the business owner is less of a concern</li> </ul>
<b>Mode of financing</b>	<ul style="list-style-type: none"> <li>▪ Suitable instruments being Ijarah and Murabaha to finance productive assets</li> </ul>

# CHALLENGES MOVING FORWARD

## Short-Term

- ✓ **Slow global economic growth and still weak financial performance in 2010** are expected to adversely affect Islamic finance development as banks and other organisations reaccess risk
- ✓ In the GCC, although liquidity is slowly returning, expect **financing growth to remain lacklustre** on the back of a challenging operating environment and concerns over banks' asset quality

## Medium & Long-Term

- ✓ The Islamic finance industry is growing at a much faster rate than it is developing and acquiring new talent. The **shortage of human capital** could turn out to be the main impediment to growth if not addressed immediately
- ✓ **Enhance product development** to address short-term liquidity needs/ management of Islamic financial institutions
- ✓ To gain wider acceptance in the global Islamic financial market and among Shariah experts, **sukuk issues need to improve their features**, which include introducing sukuk based on both receivables and assets, or enhancing pricing mechanisms
- ✓ **Strengthening Islamic bank's risk management systems**, managing investment portfolios diligently and reducing NPLs are key to the success of Islamic banking industry

# LIQUIDITY RISK BEING MOST CRITICAL FOR ISLAMIC BANKS

## Shariah-compliant money & intrabank markets

- Limited availability of Shariah-compatible money and intrabank markets has restricted Islamic banks' options to manage liquidity positions efficiently

## Secondary markets

- Financial instruments that can be traded on secondary markets are limited
- Where instruments are available, the number of market participants is limited

## Liquidity management avenues being conventional

- The interbank market, secondary market for debt instruments and discount windows from the lender of last resort are all considered as based on riba

## Characteristics of Islamic instruments

- Certain characteristics of some Islamic instruments give rise to liquidity risks for Islamic banks
- E.g. inability to trade Al Salam contracts, which can be traded only at par

## High level of idle cash

- In the absence of liquid short-term instruments, Islamic banks maintain a high level of idle cash

# PRODUCT DEVELOPMENT

Conventional instrument	Characteristics	Shariah-compliant alternative
Equity	Equity holders are the owners of the company and responsible for conducting its affairs	Accepted
Bonds	A term obligation to make a series of fixed payments	Accepted (asset-backed)
Acceptances	A written promise to pay a given sum at a pre-specified date	Developed, but not negotiable
Commercial Paper	A short-term debt security that can be easily traded	Developed, but not negotiable
Securitised loans	Pools of mortgages or other types of loans that are publicly traded	Accepted (asset-backed)
Index-linked securities	A security where payment is linked to an inflation index or a commodity price	Emerging
Commodity futures	Contracts for the future delivery of a commodity	Accepted (Salam/ forward sale)



**Liquidity management**



**Hedging**

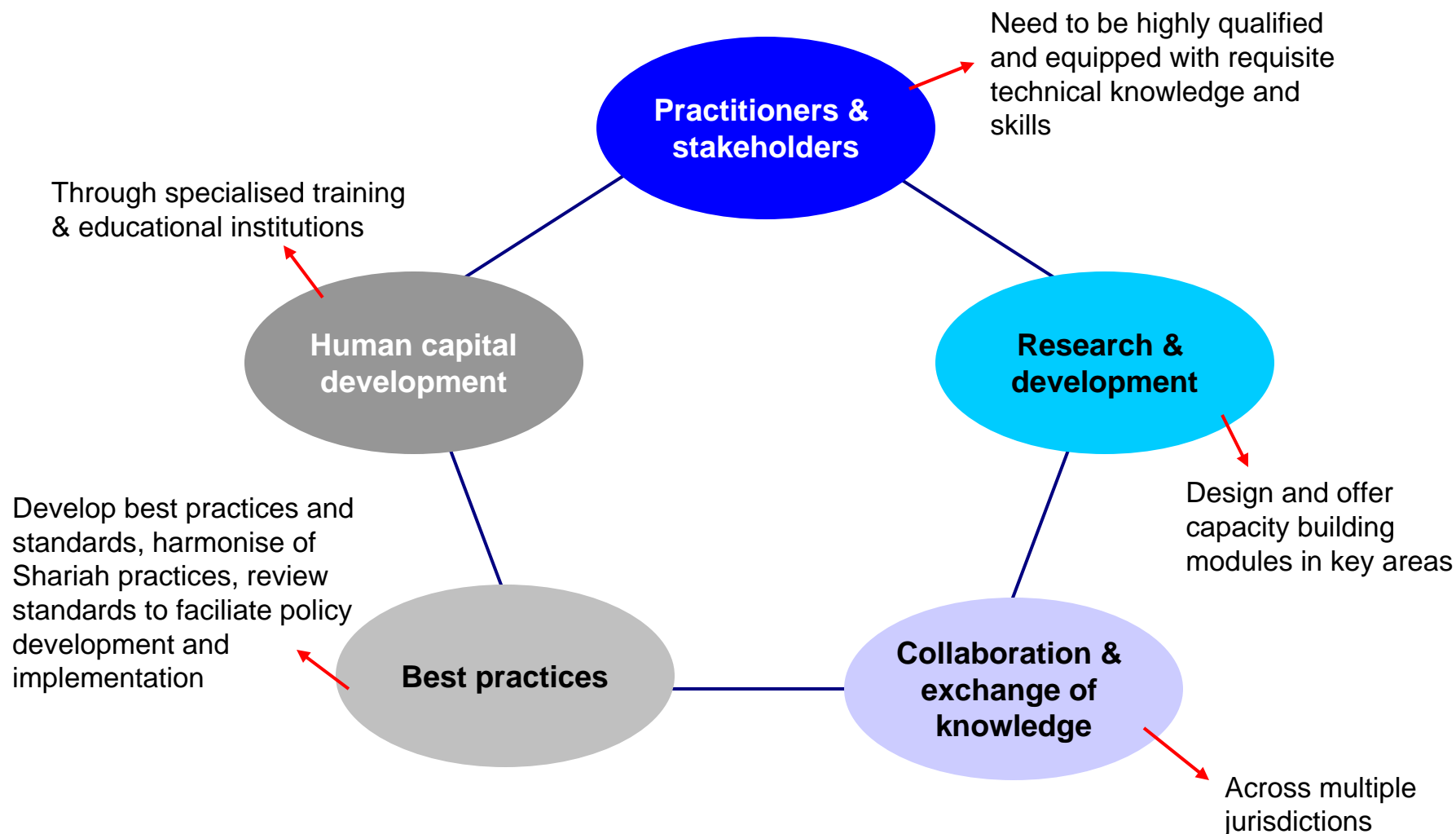


**Swap**



**Safety nets**

# CAPACITY BUILDING & TALENT DEVELOPMENT



# STRENGTHENING ISLAMIC FINANCIAL INFRASTRUCTURE

- ✓ Critical to build robust components of the financial infrastructure and strengthen key institutions to ensure the stability and dynamism of Islamic financial system
- ✓ IFSB has identified 8 building blocks aimed at further strengthening the Islamic financial infrastructure
- ✓ Challenges include human capital and enhance product development, identifying the right opportunities and delivery of appropriate returns for risk involved
- ✓ **IFSB projects Islamic assets to potentially reach USD1.6tn by 2012**



# KFH GLOBAL INVESTMENT RESEARCH



## THANK YOU

**"Contribution to Research in Islamic Finance 2009"**

International Islamic Finance Forum  
April 2009

**"Best Islamic Research Company"**

Islamic Finance News Awards Poll 2008  
January 2009

**"Best Islamic Finance Research House"**

The Asset Triple A Islamic Finance Awards  
2009

**"Best Research in Islamic Finance"**

Master of Islamic Funds Award  
November 2007

**"New Provider for Islamic Finance Research"**

5<sup>th</sup> KLIFF Islamic Finance Awards  
November 2008

**"Best Islamic Research Company"**

Islamic Finance News Awards Poll 2009  
January 2010

**"Outstanding Contribution to Islamic Finance"**

Failaka-Amanie Symposium, Dubai  
April 2010

**"Best Islamic Finance Research House"**

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