International Investor

GLOBAL ISLAMIC FINANCE

2016

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2016

International Investor

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WORLD'S ISLAMIC FINANCE MARKETPLACE

Publisher and Editor-in-Chief
Cory D'Abreo

Managing Editor
Thomas Michael Edwards

Regional Director, Asia
Janice Lee

Project Coordinator
Leba Sable

Editors
Alexis Psarras
Haley Moncrief

Production and Design Editor
Izabela Austin

Publishing Assistant
Roselin Banu

Photographer
John Poh

Circulation Manager
Louise Powell

CAPITAL KNOWLEDGE

+44 (0)20 7193 2965
info@internationalinvestor.com

INTRODUCTION: EXPANDING THE GLOBAL FOOTPRINT

The rapid growth of Islamic finance is being carefully monitored around the world, especially in countries or jurisdictions that aspire to be global financial hubs. Islamic banking has been steadily increasing its market penetration, with banking asset growth in many Muslim-majority countries outpacing conventional banking assets. And the expansion of global sukuk issuance has been nothing short of remarkable, with the instrument attracting greater numbers of issuers and investors from a broad range of markets.

Today, Sharia-compliant assets are estimated at around US$2 trillion, complimented by an asset management industry with approximately US$60 billion of assets under management (AUM). These figures are the product of compound annual growth rates over the last five years of approximately 17 and 9.5 per cent, respectively.

As a result of the increasing interest in this alternative form of financing and strong economic growth in countries with large Muslim populations not yet integrated into the banking system, the market is predicted to grow even further. Mainstream estimates suggest that the Islamic finance market could grow to over US$3 trillion by 2018, and the Islamic asset management market may exceed US$75 billion AUM by 2019. Furthermore, the projected rise in Muslim consumer spending to US$2.6 trillion by 2020 feeds into this expansion, with increasing demand from halal economy suppliers for Sharia-compliant financial services.

While the numbers relating to Islamic finance growth are impressive, they pale in comparison to total global conventional financial assets, estimated at US$294 trillion according to a 2015 study by Deutsche Bank. Clearly, there is a significant amount of work to be done before Islamic financial markets can start to make a dent in the global financial universe, and many challenges must be faced in the short and medium term.

As with any burgeoning and exciting economic sector, there are many voices attempting to adequately define the aforementioned challenges, as well as the order of priority. Yet, herein lies a more fundamental problem: without greater cohesion, cooperation and consensus between stakeholders on what the challenges are and how they should be addressed, many will either remain unovercome or the lack of concurrence will result in a number of different, and sometimes opposing, solutions, which will further fragment the market and obstruct the path towards global expansion.

In recognition of this issue, International Investor's role in the market is evolving beyond the provision of strategic business information, and into the area of industrial development services.

A key facet of the value proposition we offer is our ability to successfully bring the highest level public and private decision-makers together, in a neutral and secure environment, to productively collaborate on setting and executing strategies that result in sustainable economic growth and industry-wide development.

The primary mechanism we use to achieve these outcomes is an International Investor: Strategic Review event. The following document contains the reports from two such events, which examined the global growth of the Islamic finance market and the halal economy, respectively.

At our Strategic Review event for the Islamic finance sector, entitled ‘Priorities for the next stage of global expansion’, the discussion centred on the pre-eminent questions pervading the sector. One such issue was the role of Islamic finance in creating a more equitable and sustainable economy, and how to develop broader recognition of the industry’s alignment with these objectives. There was also serious discussion relating to the specific steps required to advance certain strategic goals, including whether the next stage of industry development meant divergence or convergence with the financial framework already in place on a global level.

The Halal Economy Strategic Review, ‘Harnessing the potential of the halal economy’, facilitated a constructive debate touching on a number of defining issues for this rapidly expanding sector. These included the development of Islamic e-commerce, and how an industry that contains a plethora of SMEs can embrace and leverage the digital economy; as well as the compatibility of conventional banking and financing models for halal businesses, and alternative risk sharing structures, such as crowdfunding.

In addition to the insights provided by the participants attending our Strategic Review events, this edition of International Investor: Global Islamic Finance offers more detailed analysis and opinion from industry thought leaders. The topics covered in our feature pieces include the European Islamic capital market growth, analyses of both public and private sector sukuk market development, the benefits of Sharia-compliant fund management, the convergence of Islamic finance and ESG Investing, the importance of Sharia-compliant financing solutions for SMEs, and the emergence of a global sharing economy.

Industry development and growth can only be successfully achieved through close collaboration, reciprocal contribution and strong commitment. This edition aims to provide perspective to all stakeholders, as well as communicate and facilitate ongoing collaboration between the public and private sector actors in the Islamic economy and the global Islamic finance industry. The intention is to drive the achievement of cross-sector industry goals, stimulate further discourse and, ultimately, illuminate the path towards sustainable growth.

Finally, International Investor would like to take this opportunity to thank the participants of both our Strategic Review sessions, as well as those who contributed additional content in what follows. We hope you consider the findings and material arising from these debates both interesting and useful.


MALAYSIA
WORLD'S ISLAMIC FINANCE MARKETPLACE

STRATEGIC REVIEW: PRIORITIES FOR THE NEXT STAGE OF GLOBAL EXPANSION

Islamic finance is becoming increasingly known for its innovative and sustainable qualities. As global recognition increases, industry thought leaders must clearly define the value proposition and the necessary strategic steps that will facilitate a progression to the next level of development.

AGENDA

- Defining the value proposition and strategic objectives of Islamic finance
  - Creating a viable alternative
  - The need for a holistic approach
  - Promoting the inherent values: sustainability, transparency, fairness and ethics
- Creating a balance between socially-responsible and profit-driven goals
  - What does this mean for financial institutions?
  - Incorporating Islamic principles into products and structures
- Industry development and potential blockages
  - Where is the corporate momentum?
  - Educating the decision-makers
  - Top-down and bottom-up approaches
    - Infrastructure and ecosystems: where there's a will, there's a way
- The big question: convergence or divergence?
  - How to compete on a playing field defined by conventional finance?
  - Ramping up Sharia-compliant asset management
  - Adapting to the framework: expounding specificities
  - Islamic finance as responsible finance
  - Promulgating important industry contributions
- Involving the small-scale investors
- Expanding the role of Sharia scholars
- Closing comments and concrete actions

PARTICIPANTS

DAUD VICARY ABDULLAH
President and Chief Executive Officer
International Centre for Education in Islamic Finance (INCEIF)

Daud has been in the financial services industry for more than four decades, with significant experience in Asia, Europe, Latin America and the Middle East. Prior to his current position, he was Global Leader of Deloitte's Global Islamic Finance Group, as well as acting CEO of Asian Finance Bank, an Islamic bank based in Malaysia. Daud holds an economic and social history degree from the University of Bristol, UK, and has co-authored the book Islamic Finance: Why it Makes Sense.

STELLA COX
Managing Director
DDCAP

Stella has been in her current role since 1998, having previously worked as an independent, non-executive director of a UK Islamic bank. In 2013, she was one of a small group of non-ministerial industry experts within the UK Government's first Islamic Finance Task Force. Stella has worked on Islamic finance market development committees formed by several overseas authorities and is also chair of the Islamic Finance Market Advisory Group established in 2014 by TheCityUK.

MOHD IZANI GHANI
Chief Financial Officer
Khazanah Nasional

Izani has a degree from the London School of Economics and Political Science and is a fellow of the Association of Chartered Certified Accountants, as well as a member of the Malaysian Institute of Accountants. In the field of Islamic finance, he has played a fundamental role in establishing ringgit-denominated sukuk programmes for Khazanah Nasional, as well as in issuances of landmark and innovative sukuk transactions in a number of distinct currencies.

DR NIK RAMLAH MAHMOOD
Deputy Chief Executive (since retired)
Securities Commission Malaysia (SC)

Nik held numerous positions within the SC during her 22 year career at the authority. She worked in distinct areas ranging from legal and regulatory reform, to product and market development, and Islamic capital market investor education and enforcement. She subsequently retired from the SC in March 2016. Nik currently sits on the board of the Securities Industry Development Corporation and holds an LLM and a PhD from the University of London.

GERALD MICHAEL AMBROSE
Chief Executive Officer
Aberdeen Islamic Asset Management Sdn Bhd (AIAMSB)

Gerald joined Aberdeen Asset Management in 2005 and is currently CEO of AIAMSB, the group's Islamic fund management hub. He previously worked as institutional sales director covering ASEAN equities at Kim Eng Securities in Singapore, HSBC James Capel in London and BNP Paribas Securities, London. Between 1980 and 1987, he served as a submarine officer in the British Royal Navy. Gerald holds a masters in land economy from the University of Cambridge.

CHUNG CHEE LEONG
President and Chief Executive Officer
Cagamas

Chee Leong has been in his current position since 2012 and has almost three decades of banking experience, focusing mainly on financial system stability and the financial sector. Prior to joining Cagamas, he served as director of Bank Negara Malaysia's Banking Supervision and Risk Management departments, during which time he conducted a number of assignments for the International Monetary Fund. Chee Leong holds a degree in business administration from the University of Malaya.

PARTICIPANTS

PROF. RIFAAT AHMED ABDEL KARIM
Chief Executive Officer
International Islamic Liquidity Management Corporation (IILM)

Rifaat is a global leader in the Islamic financial services industry at both the professional and the academic level. He previously served as the inaugural secretary general at both the Accounting and Auditing Organization for Islamic Financial Institutions and the Islamic Financial Services Board. Rifaat has garnered a number of prestigious international awards for his extensive contribution to the Islamic financial services industry over the last three decades.

DR MULYA SIREGAR
Deputy Commissioner of Banking Supervision
Indonesia Financial Services Authority (IFSA)

Mulya has held his current post since 2014, in which he is responsible for overseeing banking research and regulation, licensing and information, and Sharia banking in Indonesia. Since 2012, he has been active in a number of global organisations focused on financial system stability, including serving as co-chair of the ASEAN Banking Integration Framework, among other roles. Mulya holds a PhD and an a masters of science degree from Ohio State University, U.S.

SYED ABDULL AZIZ SYED KECHIK
Chief Executive Officer
OCBC Al-Amin Bank

Syed has been in his current position since the bank's inception in 2008. He began his career in the banking industry in 1990 at Citibank Malaysia, prior to working at two other banks, including in a senior management role at an Islamic bank. Under his stewardship, OCBC Al-Amin was named Islamic Bank of the Year for Malaysia in 2014 by the UK-based publication, The Banker. Syed is currently a member of the Chartered Institute of Islamic Finance Professionals.

ROUNDTABLE PARTNERS

MALAYSIA WORLD'S ISLAMIC FINANCE MARKETPLACE
Suruhanjaya Sekuriti Securities Commission Malaysia
DDCAP Group
Aberdeen Simply asset management.
OCBC Al-Amin
Cagamas National Mortgage Corporation of Malaysia
OJK Indonesia Financial Services Authority

GLOSSARY

SHARIA
Often referred to as Islamic law, it encompasses the rulings contained in and derived from The Koran and the Sunnah, which are the sayings and living example of the Prophet Muhammad. It is primarily concerned with a set of values that are essential to Islam and governs not only religious rituals, but also all aspects of daily life. There is extreme variation in how Sharia is interpreted and implemented among and within Muslim societies today. This is especially prevalent for its financial laws.

SUKUK
A sukuk is a financial certificate that represents the holder's proportionate, beneficial ownership of an undivided part of an underlying tangible asset relating to particular projects or investment activities. In this structure, the holder assumes all rights and obligations to the asset. In contrast to a conventional interest-bearing bond structure with a contractual obligation to pay bondholders interest and principal on particular dates, the issuer of sukuk sells an investor the certificate and the asset is then leased back to the issuer for a predetermined return in the form of rental charges. The issuer also makes a contractual promise to return the principal at a future date at par value by buying their share of the asset. Sukuk must be able to link the returns and cash flows of the financing to the assets purchased, or returns generated from an asset purchased.

RIBA
Riba generally refers to charged interest, but can be translated in many ways to mean interest rate, excess, increase or addition. Technically, it refers to any increase or addition to capital obtained by the lender as a condition of a loan. Simply put, it covers earning money on money. Riba, in all forms, is strictly prohibited under Sharia law, as it is considered an unjust return that leads to unjust enrichment. This, in part, is due to the fact there is no productive or trade activity to create the additional wealth. In Islam, money is seen as only a medium of exchange, it has not value in and of itself and should not give rise to more money.

IJARA
A type of contract that refers to an agreement made by an institution offering IF services to lease a particular client an asset specified by the client for an agreed period against specified instalments of lease rental. Neither party may alter the contract without dual consent.
Ijara is classified into 'operating ijara', which does not include a commitment to transfer the legal title of the leased asset to the lessee at the end of the lease, and 'ijara muntahia bittamleek', which is completed by passing the legal title of the leased asset to the lessee.

MUSHARAKA
A type of contract that stipulates an investment partnership between two or more parties, for example an institution offering IF services and its clients. All parties contribute capital towards the financing of a particular business activity in equal or varying amounts to establish a new project or share in an existing one.The partners share the profits according to a pre-agreed ratio, while losses are shared in proportion to each partner's share of capital. Musharaka is often used by Islamic banks to finance large projects.

MURABAHA
A type of IF structure in which the institution offering IF services sells a specified kind of asset to a customer that is already in the possession of the institution, or buys a product on behalf of the client and resells the product to the same client, at cost plus an agreed profit margin.

WAKALA
A contract of agency in which the customer appoints the institution or other party to perform a certain task or undertake business on their behalf, usually for payment of a fee or commission. This kind of arrangement, without provision for payment of a fee, cannot be considered irrevocable, thus allowing an agent the right to terminate the agency at any time. Also known as al-wakala.

Daud Vicary Abdullah, International Centre for Education in Islamic Finance (INCEIF): I would like to extend a very warm welcome to all the participants; there is certainly much to discuss, so I will forego a lengthy introduction. There are three broad areas that we will cover during this discussion: the value proposition of Islamic finance; the role of Islamic finance in creating a sustainable economy; and issues related to creating a level playing field with conventional finance.

Accordingly, I would like to begin by getting a sense of the current value proposition of Islamic finance and what participants identify as the industry's core strategic objectives.

Prof. Rifaat Ahmed Abdel Karim, International Islamic Liquidity Management Corporation (IILM): Islamic finance is trying to provide a viable alternative to a certain group of individuals who wish to adhere to their faith. This objective may seem straightforward, but it actually requires significant infrastructure being in place. Thus, in order to provide the value proposition to this group, Islamic finance must have the necessary infrastructure in accounting, prudential supervision, liquidity management and, of course, human resources, among other areas. Industry development and advancing the value proposition demand a holistic approach.

Stella Cox, DDCAP: Of course, I certainly concur with Professor Rifaat's point. Currently, the key issue is that the infrastructure in some territories is rather more developed than in others. Yet, ultimately, the industry's value proposition rests on its global footprint; it is the responsibility of involved jurisdictions to work together and collaborate with the objective of trying to move each one to an equal footing over time.

In terms of the holistic approach, while there has been an extensive focus on the prudential side, one area that is rightly becoming more prominent and is certainly required to enhance the value proposition is the development of human resources through structured education and training.

Dr Nik Ramlah Mahmood, Securities Commission Malaysia (SC): When I hear 'value proposition', I think of the inherent value of Islamic finance. First, it is inherently sustainable and ethical, due to the foundational elements of Islam. Achieving sustainability is a process affected by numerous variables, but these elements and prohibitions put the industry on a solid path.

Second, Islamic finance must be linked to the real economy, real assets, real transactions, which, as you all know, is quite different from conventional finance. By some estimates, the size of conventional financial assets is four times global GDP; the Islamic finance framework would not allow this predicament. It is about financing, not the financialisation of the economy.

Finally, the numbers speak for themselves. Figures often cited suggest that the world's two billion Muslims are growing at double the rate of non-Muslims and that by 2030 Muslims will make up more than a quarter of the global population. This, coupled with the relative size of economies in the Middle and North Africa, Asia and Sub-Saharan Africa, for example, shows that demand will certainly not be lacking.

Dr Mulya Siregar, Indonesia Financial Services Authority (IFSA): At the IFSA, initially we approached Islamic finance development from a legalistic perspective, but quickly realised it would be more prudent to shift our approach to one based on value orientation, i.e. engaging finance to achieve positive socio-economic goals. In other words, we moved from a prohibition orientation to a maqasid orientation, which is aligned with the objectives of Sharia.

Building on this approach, it is important to point out that Islamic finance should be 'development relevant' in order to be truly and meaningfully Islamic, rather than 'development neutral'. Moreover, a further shift is needed from poverty-neutral to poverty-sensitive; it must be a clear industry aim to improve the lives of citizens and reduce poverty. The latter is linked to another shift from debt orientation to equity orientation.

In some areas, Islamic financial institutions have a parochialistic approach, as opposed to aiming for universalism. Islam is not meant for any particular group of people, but for all humanity. The principles of Islam pertaining to finance are universal in nature: fairness, ethics, transparency and sustainability. Thus, we must execute these shifts in perspective to enhance the value proposition of the industry.

Daud Vicary Abdullah
President and Chief Executive Officer
International Centre for Education in Islamic Finance (INCEIF)

Chung Chee Leong
President and Chief Executive Officer
Cagamas

Gerald Michael Ambrose, Aberdeen Islamic Asset Management Sdn Bhd (AIAMSB): From a fund management point of view, while I agree with principles like poverty-sensitive over poverty-neutral, as an industry we are entrusted with funds for augmentation, in many cases, to provide for our client's future. There must be some profit share available.

Bonds issued under the Ihsan Sukuk Programme, for example, have been quite difficult to sell to fund managers, as they cannot quite fathom a scenario in which, if the underlying project is a success, you get less money back! There must be opportunities for investors to find returns.

NRM, SC: That is a very pertinent point: to what extent should the design and development of Islamic finance, going forward, be demand driven? How far should the industry align itself with the requirements of fund managers, for example? Clearly, it has to be to some extent, but is it all about what can be sold?

It is a very delicate balance; we have to find the landing from somewhere. Hitherto, the design has been based on what sells and that is part of the problem. It is the root of the accusations relating to the replication and adaptation of conventional products.

DVA, INCEIF: You have both anticipated one of today's key discussion topics. Arguably, the perception is that the Islamic aspect of the industry is largely philosophical, but, operationally, it is in close proximity to conventional finance. Yet, this reality was born out of necessity and we are at a stage where this can begin to change. Accordingly, the debate must now focus on balance.

Clearly, undertaking socially orientated activities is a central pillar of Islam and there are already financial instruments that facilitate this, such as zakat and waqf funds, but where does finance fit in here? If the finance part is a means to an end, are we, for instance, merely looking at asset management driven by waqf?

The 2008 Financial Crisis was a fulcrum that accelerated the search for alternative forms of finance; thus, spurring interest in Islamic finance. We must now articulate what that means for the various branches of finance, such as asset management. Some market actors contend that the financial services industry should primarily serve as an intermediary producing outcomes that impact on all humanity. Now, these outcomes should be charity and corporate social responsibility focused, but there also must be profit.

Chee Leong, Cagamas is primarily involved in mobilising funds, how do you see this issue in the context of your role and objectives?

Chung Chee Leong, Cagamas: From the perspective of a regular sukuk issuer, when we design a structure, including our current Multicurrency Medium Term Note (EMTN) programme, we would ensure that it is based on globally accepted Sharia principles, which in this case is the wakala principle, in order to broaden the appeal, particularly to Gulf Cooperation Council investors. Thus, the demand factor is important.

> *"Many jurisdictions with huge Muslim populations ... are either underserved or not served at all because of the lack or non-existence of Islamic finance facilities"*

Accordingly, we have been pondering how to structure our sukuk in a manner that is not only geared towards meeting investor demand, but embodies the socially responsible remit of Islamic finance. Cagamas already facilitates government policy by helping to provide affordable housing, for example, but we are investigating the ways in which our instruments can better meet this dual purpose. If we take waqf funds, for instance, there are possibilities to invest these funds in the capital markets to provide further affordable housing.

Having said that, there are still significant opportunities in the sukuk space. We are in contact with many jurisdictions with huge Muslim populations that are either underserved or not served at all because of the lack or non-existence of Islamic finance facilities. The Philippines is one example, and they have approached Cagamas for help in designing instruments to meet their demand. I think the multilateral agencies should certainly assume the mantle in terms of Islamic finance promotion.

Regarding objectives, following Stella's point, enhancing awareness and understanding of Islamic finance is very important. In jurisdictions that are not financial centres or are non-Muslim majority, our conversations with investors about sukuk often must begin with explanations. However, this can change. For example, after the Hong Kong Government issued sukuk, understanding of sukuk by the Hong Kong investors increased exponentially. Notwithstanding this development, investors in Japan, South Korea or Taiwan, for example, still do not grasp sukuk fundamentals; it is either too complicated or they prefer to stick to conventional if they cannot secure a higher yield. Thus, we must collectively instigate an industry-wide communication strategy, especially in new markets.

Syed Abdull Aziz Syed Kechik, OCBC Al-Amin: Returning to the value proposition, two key points bear reiterating. First, Islamic finance creates an alternative market for the Muslim community to undertake banking in accordance with Sharia. Second, it creates the required market for the Islamic banking business that facilitates real economic activity.

OCBC Bank has a presence throughout Southeast Asia, and Islamic banking, on regional basis, is a key focus for us. The decision to locate the company's Islamic finance centre in Malaysia was straightforward. The country has led the way in this sector and has painstakingly constructed the right ecosystem for further development. Consequently, we have put significant weight behind our operations here.

In terms of core strategic objectives, over the last 40 years the Malaysian Government has achieved the goal of significantly increasing the market share of Islamic banking. It currently stands at approximately 25 per cent, but Bank Negara Malaysia announced in 2011 that the goal was to achieve a 40 per cent market share, in terms of total banking financing assets, by 2020. That is a big challenge, but in order for the industry to continue to be relevant, this degree of scaling up is key.

Another focus should be on rebalancing. While we have seen remarkable developments on the asset side, there has been some lagging on the liability side; in my opinion, there is too much focus put on the asset side. In Malaysia, all the products are already in place: capital markets, trade finance, project financing, working capital lines, so the next phase should include a lot more development in wealth management. From our bank's point of view, the four main categories of wealth management products would be deposits, as well as the structured investment products, unit trusts and bankatakaful.

> *"While we have seen remarkable developments on the asset side, there has been some lagging on the liability side"*

Syed Abdull Aziz Syed Kechik
Chief Executive Officer
OCBC Al-Amin Bank

As far as the consumer banking business is concerned, there must be more development and innovation here.

NRM, SC: I would just like to add that the Securities Commission (SC) is currently working on a blueprint for Islamic funds and wealth management, which is intended to cover asset management and private wealth management. I fully agree that wealth management is the next area for development, hence our focus here.

DVA, INCEIF: Let's bring Izani into the discussion. Khazanah Nasional is clearly engaged, but what is your strategy and agenda? How important are the ideas that Mulya highlighted in terms of your fulfilling the fundamental objectives of Islamic finance?

Mohd Izani Ghani, Khazanah Nasional: In 2005, Khazanah resolved to make Sharia-compliant transactions our mainstream financing choice. We knew we were going to do a lot of financing and demand for capital from Khazanah would be high, so it was a tough call to make up front; however, due to this commitment, we had the determination to follow it through. This compelled us to devote the required resources, to take the difficult decisions, and, importantly, to innovate and explore in terms of structures.

This is borne out by our transactions. For our 2006 and 2007 exchangeable sukuk, we designed a structure that fit our requirements. In both instances we encountered

Mohd Izani Ghani
Chief Financial Officer
Khazanah Nasional

problems relating to the need to restructure the company's non-Sharia-compliant debt, which also generated pushback from the underlying company's management. However, we were able to move forward because of our ideological commitment. In fact, with our PLUS exchangeable issuance in 2007, we went together with PLUS to meet the SC's Shariah Advisory Council to discuss steps towards purifying PLUS's capital structure.

> *"For the Ihsan Sukuk Programme, we decided to design an instrument to target like-minded people, who want to give back to society"*

Since then, we have sustained our momentum, in part due to our continued commitment to innovation. The Ihsan Sukuk Programme is a good example of this. In 2010, Khazanah started to look at the education sector. The public were unimpressed with the quality of Malaysian schools, but the issue was not being addressed adequately, particularly by the private sector. Accordingly, we set up the Yayasan Amir Trust Schools programme and, beginning in 2011, started to fund a broad cross section of schools using internal Khazanah funds.

After four years, the results were outstanding. One school in Johor moved up 2,000 places in the overall rankings. The attendance at that school increased, the teaching improved, there is greater parent participation, and that is just one example. Accordingly, we wanted to continue the development of the trust programme, but diversify the funding because Khazanah had been shouldering the entire burden. So, for the Ihsan Sukuk Programme, we decided to design an instrument to target like-minded people, who want to give back to society.

The social impact bonds, which had been launched in the UK, piqued our interest, but in this model a step-up yield was provided as an incentive. Thus, the government commits to pay for improved social outcomes that result in public sector savings: reducing recidivism, for example.

Clearly, if Khazanah issued a sukuk with these terms we could raise significant funds; it would be ludicrously easy to sell, but it would not be so impactful. Our aim was to draw out investors that wanted to give and integrate a gift element into the bond. Accordingly, we took the decision to structure the sukuk in such a way that the yield would be reduced if the schools met the required Key Performance Indicators (KPIs). It was another innovative structure that required resolute decision-making.

Thus, in 2015, we issued the ringgit-denominated sukuk priced at par to yield 4.3 per cent, in line with our curve and slightly above the fixed deposit rates at the time. In year five, there will be a KPI review and if the targets are met, investors will face an 80 basis point reduction to 3.5 per cent.

Needless to say, it was a challenging roadshow, our first ever for a ringgit-denominated bond and for only MYR100 million, a relatively trifling amount compared to our previous issuances. We convinced the foundations and the corporates; the bank treasurers were the most difficult to manage because they were decidedly sceptical about being able to convince their own bosses to take the yield reduction, but some came around.

GMA, AIAMSB: You are making fund managers sound like the unacceptable face of capitalism! I think it is important to find ways to convince funds to invest in these types of programmes. If we had principals, government-linked pension funds, for example, who would provide us with a remit to invest a percentage of our assets in these kinds of corporate social responsibility (CSR) initiatives, we would be absolutely happy to do so. On the wealth management side as well, I think there are significant opportunities, as many individuals would see it as a good investment.

MIG, Khazanah Nasional: One other important feature of the programme is the option to waive the principal and give it to the trust at any stage during the seven-year tenor, which counts towards the giver's tax exemption.

The implication of this for Khazanah is that the more investors donate through this instrument, the more internal funds are freed up for allocation to other CSR activities on an annual basis. Moreover, this structure can be applied in a plethora of other sectors: affordable housing or healthcare, for example. It is a channel that allows people to give back to society and take decisions

about further giving, while stimulating social spending. It has really caught the imagination, we have proven this kind of structure can work; people are talking about it and we hope that it will be replicated and used by other countries and institutions.

DVA, INCEIF: I want to get some perspectives from participants on industry development, globally speaking and in their own markets, and how they see Islamic finance moving forward from the point at which it stands now. Moreover, are there any potential blockages to development that must be addressed?

SC, DDCAP: Fundamentally, in terms of direction, development and forward progress, as I mentioned in my opening remarks, it depends on where you are located geographically.

The UK market supports five, wholly Sharia-compliant banks, as well as a Sharia-compliant insurance underwriting agency. I chair the Islamic Finance Market Advisory Group (IFMAG) that sits within TheCityUK, a private sector organisation that represents UK-based financial and related professional services. TheCityUK works with the UK Government through its seat on the HM Treasury-led Financial Services Trade and Investment Board (FSTIB). The FSTIB has nine different work streams: Islamic Finance is one.

London is a leading global centre for professional financial services so, unsurprisingly, we have many high-quality, professional financial advisory firms among IFMAG's membership. Thus, when we meet, we include focus on the expertise we have in the UK across the legal, prudential, advisory and accountancy spectrum. The front offices of our financial institutions are often located in the core hubs for Islamic finance, as client connection is important, which enables conducive discussion about the broad development of the industry when working groups and similar committee meetings are convened overseas.

The UK Government has clearly set out its agenda. There can be no argument that the UK is the Western hub for Islamic finance; no other European nation has made a concerted effort to authorise Sharia-compliant banking institutions, for example. However, we cannot be complacent and we need to continue to push.

Asset management is in focus with major firms, such as Aberdeen Asset Management, prioritising Islamic financial market strategy. Specifically in terms of asset management, we see a lot of the potential in harnessing the growth in that sector to the development of Sharia-compliant financial technology. Already in the UK, Fintech has extended its reach to niche or focused subsets of the financial industry. This is where we also see strong interest from Muslim entrepreneurs in the business world, both within the UK and throughout Europe.

"If we want to drive the European Islamic capital market prospects forward, we must focus on the delivery of focused, professional education"

Another important consideration for the UK industry is how to build on the financial architecture that has been implemented. There is already a Sharia-compliant capital markets platform and the inaugural UK sovereign sukuk was issued in 2014, but I think there has been a lack of corporate momentum following these developments. For example the Eurosukuk market has not materialised, which is a disappointment to many observers. Although there may a be number of valid reasons for this, we cannot set it aside and must still establish a clear pathway to achieve our objectives.

In my opinion, this pathway must include a concerted effort to educate senior, corporate decision-makers. A significant number of major UK and European corporations have been accessing Islamic finance for a long time through private market arrangements rather than through public Islamic market issuance. However, the biggest problem in the European space is convincing the chief financial officer. Thus, if we want to drive the European Islamic capital market prospects forward, we must focus on the delivery of focused, professional education. This will bring us a little bit closer to meeting one of the core strategic objectives of the industry.

DVA, INCEIF: I think there is general agreement about the importance of delivering education. Often there is

Stella Cox
Managing Director
DDCAP

Dr Mulya Siregar
Deputy Commissioner of Banking Supervision
Indonesia Financial Services Authority (IFSA)

an attempt to implement a one-size-fits all approach, but it requires a multi-layered and nuanced strategy that must be developed over time.

We must also consider which markets to prioritise. I have had conversations with a number of well-respected Islamic finance thought leaders that are adamant the U.S. is the key target market for education. Yet, the ethical value arguments will not be enough there, it will also require empirical evidence.

GMA, AIAMSB: One related consideration is how this form of financing compares with the competition. As part of the efforts to convince target markets, clear arguments must be made relating to why Sharia-compliant finance, fund management or sukuk are better options compared to other non-Muslim forms of finance that also pertain to the common good, like environmental, social and governance (ESG) investing or socially responsible investing (SRI).

NRM, SC: In terms of potential blockages to development, while both the UK and Malaysia have vital top-down governmental commitment, clearly demonstrated by policy, markets must have organisations like Khazanah that are willing to drive the required changes and innovate structures and products.

I am not underestimating the role of asset managers and fund managers; arguably, Islamic finance has reached this stage due to a certain degree of similarity with conventional finance. However, if we are to take it to the next level, we must liberate the industry from what has become a very restrictive playing field. Due to familiarity and similarity, investors and practitioners refuse to think any further or engage with the kinds of products Khazanah is developing.

MS, IFSA: In Indonesia, Islamic banking really developed as a result of the people demanding Islamic banking services. Even then, only one article was included in the 1992 Banking Act, which related to Islamic finance allowing for the possibility of banks to operate based on profit and loss sharing.

This stimulated the foundation of Bank Muamalat Indonesia, but there was no more progress after that until 1998, when it was the citizens again who questioned the situation. There was no government leadership at this time; the progress was as a result of citizens petitioning members of parliament to act on their behalf. Thus, the Banking Act was amended to state very clearly how Islamic banking should be operated and opened the pathway for more Islamic banks.

In 2008, the government enacted the Islamic Banking Act and the Sukuk Act, but there was still no top-down programme that targeted Islamic finance development. Consequently, important changes took an inordinate amount of time to occur. For instance, it took four years to convince the government to exempt murabaha transactions from double taxation; clearly, the bottom-up approach was not sufficient.

The decision was then taken by the Indonesian Central Bank and FSA to request that governmental development planning institutions take the lead and devise an Islamic finance master plan. At first, they were reluctant, but they realised it was fundamental to development and various government-led plans were put in place. However, even this was not enough to drive the necessary changes, so it was deemed necessary to establish a National Islamic Finance Committee to develop the industry, in the vein of Malaysia's MIFC. Consequently, it is unlikely we will have another four-year wait to change regulatory obstacles because these issues will be addressed at the top level first.

My broad point is that it requires a combination of both top-down and bottom-up approaches in order to develop Islamic finance.

MIG, Khazanah Nasional: It is also important that the industry operates with a global view. Khazanah faced a frosty reception to the idea of issuing a Singapore dollar sukuk in 2010, even though it provided a natural hedge for our asset purchases in the country. We were asked why we wanted to help Singaporeans! If we do not push the boundaries and take this to other markets, we will not advance Islamic finance any further.

In order to do this, government support in the particular jurisdiction is very important in order to implement the required infrastructure that allows the issuer to play their role accordingly. We would not have been able to undertake our renminbi sukuk without the support of the Hong Kong Government, for example.

Rof. Rifaat Ahmed Abdel Karim
Chief Executive Officer
International Islamic Liquidity Management Corporation

RAAK, IILM: Once a government or jurisdiction accepts the value proposition of Islamic finance, which is to provide a viable, alternative means of finance, then everything should fall into place. They will see the potential and implement policy to support development.

In Malaysia, for example, the government and Bank Negara played an instrumental role in setting up INCEIF to provide the required human capital for industry development. Moreover, Bank Negara, the SC, MIFC, and Khazanah Nasional are all providing sustained regulatory and practical support, as well as the infrastructure required to develop the industry.

> *"Once a government or jurisdiction accepts the value proposition of Islamic finance, which is to provide a viable, alternative means of finance, then everything should fall into place"*

The strategies can, of course, be different. In order to establish themselves as an Islamic finance hub, Malaysia decided to build strategic practical and legal infrastructure, as well as host international Islamic finance institutions.

Each jurisdiction is trying to differentiate itself in order to be a hub, which is why a top-down approach is so important because it always begins with the unified and overall objective of providing a viable alternative means of finance. That is what will drive the industry forward.

SC, DDCAP: It is absolutely correct that there has to be a mix of a top-down and bottom-up approach. In terms of infrastructure, the UK Government was able to roll out an Islamic finance roadmap, initially with a priority of financial inclusion and based on the premise that UK regulation did not preclude Islamic financial practice. While our government could not and cannot incentivise Islamic financial products and services, some changes to the legal environment were certainly required to enable it to grow. Importantly, where government could fix issues, such as with requisite amendments to legislation to level the playing field, they did so. However, while the government can set the pace by forming policy, it is right that practitioners are expected to build on that through implementation and development.

CCL, Cagamas: If the relevant infrastructure is put in place by governments or central banks, the market itself will incentivise Islamic finance practice and may not necessarily require other stimulants, like tax incentives, for example. In the international market, a corporate will have to pay a higher yield on a sukuk to generate the required interest. However, if the same corporate issues sukuk in the Malaysian market, due to the depth and infrastructure within the Islamic financial ecosystem, it will be able to pay a lower or the equivalent yield as a conventional bond.

While there may be some governmental incentives, encouraging transactions has more to do with the establishment of an adequate ecosystem.

SAASK, OCBC Al-Amin: From a retail perspective, as of 2013, Muslims constitute 61.3 per cent of the total population in Malaysia, yet even convincing this demographic to do Islamic banking is a big challenge. The crux of this issue is cost: if Islamic banking is more expensive the majority will not consider it, despite the religious aspect. This is compounded by the fact that Islamic banks have infrastructure costs that are greater than conventional banks, due to the stage of development, which limits our price competitiveness.

In Malaysia, the top-down approach from the government has been critical to the retail business, particularly regarding tax incentives. For example, the 20 per cent stamp duty discount offered by the government means the customer saves money with an Islamic mortgage and the policy has even attracted non-Muslims. These kinds of incentives are of great importance during this period of growth for Islamic finance, as they can really drive the market. Until the industry is large enough to achieve the economies of scale required to compete on a level playing field with conventional finance, policy that facilitates growth must continue until we reach the tipping point.

NRM, SC: Tax incentives are important to discuss; we have been dealing with tax issues for as long as we have

been promoting Islamic finance and capital markets. Due to the structure of Islamic financial transactions, it is important to remove the tax disadvantages and move towards tax neutrality. That is relatively easy and most jurisdictions will recognise the need to ensure parity.

> *“Due to the structure of Islamic financial transactions, it is important to remove the tax disadvantages and move towards tax neutrality”*

Malaysia went one step further and provided incentives, as the government was fully committed to Islamic finance. While the policy has been a significant success and the decision has served both the industry and the country well, incentives like these may be problematic for other countries because, arguably, tax incentives introduce a discriminatory element to the regulatory environment.

DVA, INCEIF: As an extension of this discussion, we must consider whether Islamic finance must divorce itself from conventional finance in order to make it more sustainable, or if there is a structured path towards convergence with conventional finance to be followed? The latter would, in effect, require an admission that the industry will never be completely removed and, consequently, require agreement on what degree of differentiation is acceptable.

RAAK, IILM: In order to become a hub, you must cater for the specificities of Islamic finance or, perhaps more importantly, be able to cater for those specificities. For example, INCEIF has had and will continue to have the support of the Malaysian Government to cater for the specificities of Islamic finance.

To be a hub, you have to take concrete steps. That is why the Malaysian Islamic finance ecosystem has increased exponentially since 2000, as a result of top-down initiatives. The Islamic Financial Services Act has been passed, the takaful industry has been developed, the educational framework has been laid, MIFC has been established, and the country is the largest sukuk issuer. It is the sum of these parts that creates momentum.

DVA, INCEIF: Interestingly, Malaysia has created this ecosystem, which has been very successful. However, perhaps this progress has inadvertently increased the gap from those following because the specificities are understood at multiple levels.

SC, DDCAP: Education will play a key role here and there has been a significant top-down focus in the UK to develop the educational infrastructure to support Islamic finance, but this effort must be approached from a holistic perspective. To this end, we are very interested in global partnerships to help development and improve standards and consistency.

In academic education, we are working to help the universities with their efforts to ensure that the content and delivery of individual courses and the qualifications attached to them are consistent, as far as it is practicable. This is also to the extent it is appropriate as there are currently no formally agreed global standards. There is also the practical issue of graduate employment and new entrants’ access to the industry. We try to support this and are addressing it in our own way at DDCAP by offering internships to students, which is one important method of supporting human resource sustainability.

A number of former members of the UK Government’s Islamic Finance Task Force, who worked on the preparations for the UK’s sovereign sukuk issuance, now sit on the advisory boards of various UK universities. Among them is the University of East London (UEL) that evolved an Islamic finance education strategy and is working quite closely with INCEIF, for example.

The Chartered Institute of Securities and Investment offers the Islamic Finance Qualification, a professional qualification which, during the past ten years or so, has become a global leader in its space.

DVA, INCEIF: The governor of Bank Negara, Zeti Akhtar Aziz, has highlighted the importance and international stature of INCEIF, which was heartening to hear. It is very much a medium- to long-term play that is required to build up the next generation and, as Stella mentioned, ensure industry sustainability.

Dr Nik Ramlah Mahmood
Deputy Chief Executive
(since retired)
Securities Commission Malaysia
(SC)

Gerald Michael Ambrose
Chief Executive Officer
Aberdeen Islamic Asset Management Sdn Bhd

Coming back to the issue of convergence or divergence: how do we navigate the need to compete on a playing field that is defined by conventional finance? Must we break completely free from it or operate in some level of parallel existence? If the latter is the case, what are the immediate steps that must be taken in order to work in parallel with the conventional system?

SC, DDCAP: From the perspective of an external observer, Malaysia has always been lauded in the international markets due to the manner in which it has successfully implemented a framework in which the Islamic and conventional financial systems operate in parallel, but with the scope and coherence to co-operate when it is necessary and appropriate.

SAASK, OCBC Al-Amin: I am of the view that the parallel operational model should continue for now. The key factor in this respect is to develop the right business model for Islamic banking. Islamic banking windows worked reasonably well, but the concept is problematic as it encourages the perception that Islamic banking is a subset of the conventional industry. When Islamic banks become separate legal entities it generates more competition and fosters development.

However, while the standalone, parallel model is successful in Malaysia due to the top-down approach and the ecosystem, I am not sure it would work on the global level. The costs are very high to set up a separate legal entity, which will always generate a significant question mark for shareholders. Furthermore, even though the Islamic subsidiary will not have the same scale as its conventional sister, it would still have to comply with the guidelines set out in the Third Basel Accord, as well as prudential standards and risk management issues, which is a real challenge. Even with the market vibrancy in Malaysia, Islamic banks still have issues relating to compliance management.

Thus, shareholders will only authorise the establishment of these entities if they can ensure certain returns and extract additional value.

MIG, Khazanah Nasional: From my perspective, as long as Islamic banking remains under the parentage of a conventional bank, it will restrict the kind of ideas and thinking required to advance the industry. It must be independent.

Of course, at present, there is a need for closer relations in order to find cost savings and offer competitive products, but at some stage there has to be progress, especially in Malaysia. The industry here must think very carefully about what must happen to lay the groundwork for truly separate entities.

For example, currently the board members of Islamic banks in Malaysia are mostly made up of conventional practitioners; this will certainly not lead to the innovation and the kind of mandates required to advance Islamic banking. This fact perhaps points towards the establishment of an Islamic megabank as part of a solution.

> *“One challenge is the lack of convergence between jurisdictions... due to differing views regarding what is permissible, particularly in equities”*

SAASK, OCBC Al-Amin: If we operate a dual system, issues related to cost and investment come into play, but I agree that the ultimate goal has to be separation. Yet, to reach that stage will require a lot of progress in terms of scaling up the market itself.

DVA, INCEIF: Moving on from banking, asset management uptake is even smaller and Sovereign Wealth Fund (SWF) investment in Sharia-compliant stocks, for example, is miniscule. Gerry and Izani, you both must have a view on this, what is it going to take to ramp up Sharia-compliant asset management or persuade SWFs to increase investment in this direction?

GMA, AIAMSB: Aberdeen Asset Management has always invested in sukuk, even before Aberdeen Islamic Asset Management Sdn Bhd existed. However, it was judged by the same criteria as conventional issuances: the bond that offered the best return for the credit rating would be part of the portfolio.

One challenge is the lack of convergence between jurisdictions; we still have difficulty selling Sharia-compliant fund management services outside Malaysia, due to differing views regarding what is permissible, particularly in equities. In the Middle East, for example, some investors may find the fund management services we provide unacceptable, due to the regulatory framework within which we exist.

Moreover, in the past, there was a fear of cannibalisation between the conventional and Islamic business segments. The company manages a lot of funds for Middle Eastern SWFs; consequently, there was concern that an Islamic fund with a two-year track record would simply take money from the conventional to the Islamic side.

NRM, SC: In terms of asset management and your question regarding convergence or separation, from a regulatory perspective, we operate on the principle that all products and services must fulfil the objectives of securities regulation as embodied by the International Organization of Securities Commissions (IOSCO), i.e. the protection of investors, a fair and orderly market, and the avoidance of systemic risk.

While products or funds that claim to be Sharia-compliant should have an extra level of supervision in order to ensure their integrity, even guidelines that seem specific to Islamic finance are in pursuit of the IOSCO objectives. Furthermore, we want the experience to be seamless, so that someone who chooses an Islamic product will be given the same level of assurance and disclosure that you would receive if you opted for a conventional product.

DVA, INCEIF: Having set this regulatory objective, from a fund management business perspective, is there any empirical evidence to demonstrate that performance of an Islamic or Sharia-compliant fund is better than its conventional counterpart, or is the draw solely related to its ethical and socially responsible elements?

GMA, AIAMSB: Many Sharia indices are quite recent and date from the early 2000s. Over the past eight years or so the Dow Jones Islamic Market World Index has periodically beaten its conventional counterpart, noticeably when conventional bank and insurer equities did poorly, although it has underperformed in the long run. So Sharia-compliant funds may have defensive merit, depending on your view of financials and the scope for another crisis. We have two such funds, which are three years old, that have performed creditably versus their conventional counterparts.

In Malaysia, there is a critical mass of Muslims, so you have the necessary principle-based demand that can bring success, but, globally speaking, the major investor concern will be performance.

SC, DDCAP: Outside of Malaysia, one of the development issues for Sharia-compliant fund management is that, historically, Islamic funds have frequently not performed as well as conventional funds. Before the 2008 Financial Crisis, there were a number of attempts to bring Islamic funds to market, often by banks rather than the big asset management firms. These were not successful for a variety of reasons, among them that various ineligible conventional stocks outperformed over a considerable period. Furthermore, certain investors were perturbed by the impact of Islamic screening processes in niche and narrow asset classes which resulted in much elevated volatility.

There was also a point when fund sponsors were anxious to capitalise on their own perceived 'demand' for Islamic funds, but were disappointed with the size of assets under management because they consistently failed to define their target investor market.

Another hindrance to the development of this segment was the negative experience, particularly for many Middle Eastern investors, of redemption suspensions and deferrals introduced by managers during the 2008 Financial Crisis. As investors were effectively prevented from withdrawing their funds, it negatively impacted perception and investment decision-making processes for an extended period afterwards.

Finally, if we average out the assets under management of Islamic funds across the board, historically there have been limited examples of their comparing favourably with conventional counterparts in terms of size. Gerry is correct regarding the more recent performance achievements, which will adjust perception over time, but our clients have not always

been overly enthused and have expressed concerns about potential performance distortion caused by Sharia screening, the extra cost of Sharia validation itself, as well as the increased fees fund managers sometimes charge because it is Islamic. These issues must be confronted and addressed.

GMA, AIAMSB: For non-Muslim clients, I do not think you can argue that Sharia fund management outperforms conventional, which essentially means it must be promoted as a form of SRI or ESG investing.

DVA, INCEIF: Therefore, how important are opportunities, discussed within the Responsible Finance Institute (RFI) and at the Ethical Finance Forum, for example, to align more closely with the ethical and responsible finance segments to build the critical mass required, while pushing the idea that Islamic finance is not radically different and intrinsically equivalent? Is that the approach to take?

GMA, AIAMSB: Yes. Given the irrational fear of Islam that has been promulgated by the coverage of events in the Middle East, the term 'Islamic fund management' can sometimes produce a negative reaction from clients. One possible way to rationalise these fears could be to highlight that the Koran is the earliest and original form of SRI.

RAAK, IILM: The RFI was conceived as a mechanism to highlight and study the closeness between Islamic finance and responsible finance. Many have already made this connection and the institute was established to convince more people and promote this idea.

The single most important fact is that Islamic finance is responsible finance, and if the Islamic finance world can contribute to enhancing the visibility and perpetuation of both schools of thought, it is a worthwhile pursuit. Thus, events like this are an important part of the roadmap.

Moreover, this framing will allow the Islamic finance world to broaden its vision and consolidate a new pathway linked with the increased interest and initiatives related to responsible finance. A number of supranational institutions have been implementing initiatives related to responsible finance, like the United Nations-supported Principles for Responsible Investment (PRI), which is currently executing its Strategic Plan 2015-2018.

However, the Islamic finance industry must look at how it can integrate and contribute to these initiatives. The industry cannot take for granted that it will just fit in; in order to claim that Islamic finance is responsible finance, we must substantiate these claims with evidence. That is what we are in the process of doing at the RFI.

DVA, INCEIF: What I am hearing is the increasing need to deal with the detail across the spectrum. The question is, how would you take that globally?

RAAK, IILM: In order to expand Islamic finance on a global level, we must aim for integration because conventional finance dominates the current system. Thus, in terms of regulation, it is vital to start with what is already in place, but clearly explain the specificities of the Islamic system to the conventional authorities. In this way, the industry can foster joint agreement relating to policy and regulatory actions that will take these differences into account.

Accordingly, there must be a detailed understanding regarding the implications of Basel III. The Basel Committee on Banking Supervision (BCBS) has essentially deferred responsibility for reconciling Basel III with Islamic finance to the Islamic Financial Services Board (IFSB). This is because the IFSB is the platform through which Islamic finance regulators are involved and it can help the BCBS gain a better understanding of the specificities to which I have been alluding.

For example, regarding capital adequacy, to enter into a basic murabaha contract the bank is required to first acquire the asset backing the transaction in order to be able to sell it. Hence, the bank is exposed to market risk for the period during which it holds the asset before the asset is sold or leased and transformed into a credit risk. Even at the time of implementation, Basel II did not cater for this transformation from market to credit risk.

We must consider issues relating to monetary policy, for example, if a central bank decides to tighten or loosen monetary policy using interest rates. To operate a dual system there must be an understanding of how these monetary transmission mechanisms apply to Islamic financing. In order to develop a level playing

field and implement a monetary policy that works for both conventional and Islamic, you have to cater for the specificities of the latter without creating arbitrage.

It is vital to work under the regulatory and supervisory umbrella. Thus, the capital adequacy example from the Basel II framework is important. At the IFSB, we started with the conventional framework and had common starting points, which enabled forward progress.

This realisation has informed our approach at the IILM. An important aspect of Basel III is High Quality Liquid Assets, so we looked at what was required and developed our own version of an Asset-backed Commercial Paper programme, which was highly rated A-1 by Standard & Poor's, the credit rating agency. This has assisted the IILM in the sense that the price of its short-term sukuk did not fluctuate over a period of time, thus meeting conventional criteria. However, we adapted the programme to the Islamic finance specificities. The point is that we have again worked in the realm of conventional finance in order to be able to integrate Islamic finance specificities into what already exists.

NRM, SC: The same approach has been taken within IOSCO. In fact, as early as 2004, a working group was looking at the regulatory issues relating to Islamic products. The conclusion was that Islamic products could be introduced in any well-regulated capital market and this was reaffirmed in 2008 because the objectives remain the same.

The SC also takes this approach. For example, in order to issue a sukuk, the basic requirements relating to bonds apply. The Sharia-compliant aspect of the guidelines is over and above the minimum that is required for all capital markets. We certainly would not have got this far if we had started with a blank sheet of paper.

SC, DDCAP: I understand where Professor Rifaat is coming from; the issue of detail is vital for global Islamic finance development. In the UK, I think there is a significantly deep understanding of specificities and they have been identified and addressed, as far as possible. However, in some territories, understanding the issue and being able to take action are two very different things. There are some aspects that have not been addressed either due to policy, unwillingness, for reasons related to prioritisation, or because some changes are just not going to happen due to prudential considerations.

However, London is the leading global financial centre, the markets are very, very deep and there should be no doubt that, as a jurisdiction, the UK can contribute significantly to the connectivity of global Islamic financial services and the flows that surround it. London offers a complete proposition that other Western centres cannot currently provide, with the exception of the U.S., which is by no means yet an evolved centre for Islamic finance. Clearly, further detailed work is required to identify how delivery can be achieved, and this is apparently under review.

RAAK, IILM: The competition between the UK and the U.S. for the title of leading international financial centre tends to depend on the pool of human resources available to sustain the financial industry. In terms of Islamic finance, I think neither the U.S. nor the UK can claim it has anything like what is required.

DVA, INCEIF: There seems to be somewhat of a consensus that, rather than needing a step-change in Islamic finance to a point of divergence where we go away from conventional, we need to adapt the existing framework and integrate the specificities of Islamic finance as we move forward. Is that correct?

SC, DDCAP : I am still on the fence. Ultimately, we need to go for the latter option but we are not quite there yet, although there are some incredibly interesting developments occurring, which certainly highlight a more independent pathway. In terms of social responsibility, the Ihsan Sukuk Programme and the sukuk issuances from the International Finance Facility for Immunisation (IFFIm) were really exciting.

Additionally, following the UK sovereign sukuk, the UK's export credit agency, UK Export Finance (UKEF), added its guarantee to a sukuk brought to market for Airbus' customer, Emirates Airline. This transaction was the first to include an export credit agency wrap and UKEF obligations rank *pari passu* with UK sovereign obligations. Furthermore, at US$913 million, it was the largest export credit agency-wrapped aviation sector transaction ever, conventional or otherwise.

Importantly, this is a transferable model. UKEF was involved because components of the underlying asset for the transaction, the Airbus A380-800, are manufactured in the UK. Thus, it can provide a workable capital markets template going forward to assist corporate entities in the UK and elsewhere to reflect on the capability of Islamic finance to meet their needs.

Regarding the relationship between socially responsible or ethical financing and Islamic finance, while the industry must, in my opinion, retain its unique and valuable features, there are potential, significant areas of collaboration. For example, a combination of the 'positive' screening methodology from SRI, and the 'negative' screening undertaken in Islamic finance could have wider merit. Analysis of financial ratios, a core element of Sharia screening, is not as embedded in SRI processes, for example. Therefore, in terms of exploring collaboration possibilities and providing thought leadership on developing a collaborative approach from the Islamic finance perspective, it is a vital step forward.

DVA, INCEIF: I absolutely agree. In fact, perhaps these interesting case studies reveal a third way of reaching an operational equilibrium that much faster. While adapting the existing framework to meet industry requirements, Islamic finance can clearly show relevant and distinct contributions to the financial system.

At the World Islamic Economic Forum 2015, I moderated a panel, on which Izani also sat, alongside an entrepreneur from Ghana, who was using Sharia constructs to deliver impact solutions, including medical care, pharmaceutical logistics and water solutions, using mobile phone technology. It is examples of effective Sharia-compliant solutions like this, like the UKEF wrapped sukuk, and like the Ihsan Sukuk Programme, that must be promulgated.

Chee Leong, in your opening remarks you talked about strong potential for Islamic finance in new markets, including the Philippines. What must be done to develop these new jurisdictions?

CCL, Cagamas: In the course of our efforts to generate interest in our EMTN programme, I have had conversations with many finance professionals in various different markets. During a visit to the Philippines, a number of bankers relayed to me that there is a significant part of the country's population, specifically Muslims who cannot receive interest, that must deposit money into the country's banking institutions without seeing any returns. They asked me what solutions Cagamas could provide for this problem.

“While adapting the existing framework to meet industry requirements, Islamic finance can clearly show relevant and distinct contributions to the financial system”

From my experience, this situation is by no means exclusive to the Philippines and I think this highlights an interesting facet of development relating to engagement, particularly with small-scale Islamic finance investors.

In fact, our equivalent institution in the Philippines is very interested to learn about and issue sukuk, but there are challenges relating to sufficient underlying assets infrastructure and legal and regulatory frameworks, which is the case for a lot of these nascent markets.

DVA, INCEIF: I have had discussions about a sukuk issuance that would allow for the possibility of MYR1,000 denominations and, crucially, enable greater participation. I know Khazanah has been thinking about this for several years now, in relation to low-cost housing or affordable housing.

MIG, Khazanah Nasional: Yes, retail sukuk is certainly a key point on our agenda, in addition to other mechanisms that have a social impact, as I mentioned previously. In fact, we invested in a Filipino company, the 8990 Housing Development Corporation, that develops affordable housing using pre-cast concrete houses that can be built in ten days. The company caters for people that are unable to obtain mortgages. We are very interested in these kinds of concepts that are easily transferable and can be imitated in Malaysia.

In terms of facilitating investment from small-scale investors in Malaysia, we plan to include a public

element to our social impact bond, so anyone can invest if they are passionate about education.

NRM, SC: This is a very important angle. We have been talking about sukuk and the bond market, which is high finance. It is vital that Islamic finance creates and offers opportunities for small-scale investors to participate as well; otherwise, they will continue to keep their money under the mattress.

"It is vital that Islamic finance creates and offers opportunities for small-scale investors to participate as well"

The industry must become more intimately involved with the people it represents. There has already been progress in retail sukuk, we have had the DanaInfra Nasional sukuk to raise finance for the Mass Rapid Transit system expansion in Kuala Lumpur and the Klang Valley, but we must also foster the development of other investment products, like mutual funds.

This feeds into the importance of having an adequate framework for screening listed companies because if retail investors choose to go directly to the market, they must be able to easily identify Sharia-compliant stocks. If you are talking about inclusiveness and serving the community, you cannot forget the mainstream aspect of Islamic finance.

SAASK, OCBC Al-Amin: To link the previous two broad points, from a retail perspective, we have been having serious discussions about how we can differentiate ourselves from the conventional banking system.

Initially, we wanted to have a wealth product, i.e. a time deposit with a waqf element. My team were working on this for quite some time, but there are significant issues relating to waqf because of Malaysia's federal system and the regulatory issues that emerge as a result. Thus, we shelved the waqf element because it is not necessary as long as the related investment is philanthropic, which is the path we are following now.

In terms of competition, I think there are distinct segments. The social impact sukuk from Khazanah is long-term money, whereas we are offering short-term money. Specifically, these deposits will play out in a maximum of 12 months, whereas the sukuk has a tenor of seven years. In fact, the two sukuk will complement each other and investors can capitalise on both these opportunities.

DVA, INCEIF: They may also be able to secure a higher return than depositing in a savings account. Average returns for savings accounts have been 1 to 1.5 per cent, but INCEIF has done a lot of research into the equities market and, in the last ten years, irrespective of the country or the product, the returns have averaged between 15 to 17 per cent. This situation is allowing people with small savings to secure access to a higher rate of return.

SAASK, OCBC Al-Amin: Clearly, it is not just Islamic banks that can offer these kinds of instruments and it is an add-on to a basic suite of products. However, the conventional side is not taking advantage of the potential and it is an example of how Islamic banks can innovate and differentiate themselves.

Moreover, there is certainly the prospect of developing this concept in relation to profit and loss sharing. It is complex to undertake at the moment, but if the latter becomes a reality in the banking sector in the future, these kinds of products can become a profit sharing investment account (PSIA) with a social responsibility element, for example.

CCL, Cagamas: I would like to make two additional points. Although Malaysia has a very developed bond and sukuk market, the country is lacking a retail bonds and sukuk space. Thailand, for example, has a huge retail bond market compared to Malaysia. The regulatory authority, together with the other market stakeholders, must seriously consider the best ways to stimulate this area in order to provide retail investors with opportunities to invest directly into a sukuk.

Regarding affordable housing, Cagamas is investigating how to convince Malaysia's state governments and religious government ministries to standardise the legislation relating to waqf lands, some of which have potential for development and

are currently idle, in order to unlock its potential to be used for affordable housing. This issue connects Islamic finance and affordable housing, and is a very useful and innovative initiative that would promote the development of both.

> *"The role of Islamic finance is inextricably linked with creating a sustainable economy that works for everybody"*

MS, IFSA: Connecting Islamic financial practice with the population is vital. This leads back to the discussion about the role of the industry, which, from my perspective, is inextricably linked with creating a sustainable economy that works for everybody, as well as the planet itself.

In 2015, the United Nations (UN) made the switch from Millennium Development Goals to Sustainable Development Goals (SDGs). My assessment is that the SDGs can be organised into three broad sections: goals that pertain to sustainable economic development issues, which include profit making; goals that pertain to the social aspect, which ensure a business or project does not have a negative impact on the population; and goals that pertain to the environmental aspect, which are concerned with conserving the planet. Thus, we can summarise the objectives of these goals as profit, people and planet.

The three objectives of the SDGs are being used as a reference to develop sustainable finance within the UN and it is now being actively pursued by the UN Environment Programme, as well as a number of other supranational organisations, including the World Bank and the International Monetary Fund (IMF). In fact, prior to the IMF's 2015 annual meeting in Lima, Peru, we took part in a sustainable finance group discussion, where we were heartened to discover that a large number of regulatory authorities are adapting their regulation to include sustainable finance. Most notably, the China Banking Regulatory Commission, which is looking to leverage sustainable finance to address a number of environmental issues in the country.

To these institutions, sustainable finance means the green index and green bonds, plus environmentally friendly products, renewable energy and energy conservation, as well as many other areas. In my opinion, Islamic finance already encompasses these areas, as has been alluded to in our discussion today. Islamic financial principles are embedded in these products and services.

We have been talking about convergence or divergence. I believe it is conventional finance that is converging towards Islamic finance, as a result of these developments, which, significantly, have come about as a result of pressure from the global population.

DVA, INCEIF: In terms of the UN SDGs, which are laudable, and your suggestion that Islamic finance already embodies the pillars and specifications outlined, your comments draw another pertinent question into focus relating to the role that regulatory authorities or Sharia scholars may play in terms of expediting the achievement of these goals.

Should the regulatory bodies steer Islamic finance towards these kinds of developments or, if Islamic finance is really picking this up, should the Sharia councils and boards be more proactive in delivering these outcomes?

NRM, SC: It is a difficult issue; I am trying to envisage how the role of Sharia scholars should change if we take Professor Rifaat's point that Islamic finance is actually responsible finance. If there were a realisation that the role of a Sharia board should be more than just assessing what is prohibited and approving particular financial products, and that it should take on a broader remit to look for positive elements, they would certainly have a larger role to play in the development of Islamic finance.

DVA, INCEIF: I have actually sounded out a number of Sharia scholars on this and it would be a huge challenge due to the extensive expertise they would require. It is reasonably clear whether a particular transaction structure is acceptable or not, but making adequate, informed judgements on carbon dioxide emissions, for example, may be more difficult.

Accordingly, if the industry was to encourage this change, there would need to be an agreed upon framework on which the Sharia scholars could base

judgements. In fact, I believe there are a number of standards and matrices that exist to aid investors in evaluating and differentiating between financial products described as sustainable, to which Sharia scholars could refer. I like the idea of changing the Sharia board paradigm to include the kind of positive screening that pertains to responsible finance.

GMA, AIAMSB: Surely the role of the Sharia adviser should be to ensure that the financing system, as a whole, is halal. Thus, there should be a follow-up investigation, if necessary.

MIG, Khazanah Nasional: Another aspect of this would be the responsibility of the team presenting the proposal to the Sharia board; they must be truthful in their presentation. It is not just about saying what they expect the Sharia board want to hear.

DVA, INCEIF: There is an initiative in Malaysia, similar to the Financial Institutions Directors' Education Programme training, to provide guidance to the Sharia scholars in order to enhance their understanding of the financial business.

In fact, they are quite in favour of moving in that direction. Many scholars feel they are being constrained by the fact the regulators are directing them to take decisions on particular constructs solely based on the Islamic legal maxims. Nevertheless, if it is generally agreed that the Sharia scholars are expected to look at the bigger picture, that is a positive step.

I would like to focus the closing comments on broad or specific actions that participants have identified to advance industry development, perhaps as a result of today's discussion. What are the key takeaways that will inform your thought processes and deeds in terms of taking Islamic finance forward?

SAASK, OCBC Al-Amin: The key issue is differentiating Islamic finance or, in our case, specifically, Islamic banking from the conventional system.

In practical terms, the demand is there, but people will always look for the easily identifiable economic benefit. If we are better or equal, then consumers are likely to take the decision to do Islamic banking.

Islamic banking is still behaving like conventional banking because it operates as a profit-making organisation. Thus, the aspect we can change immediately in order to create our own space is to promote the socially responsible purpose of Islamic banking.

Clearly, there is the potential to create different products like the PSIA, but currently it can only be a small percentage of your total operation, due to the cost of adhering to the prudential standards and creating the infrastructure required. Nevertheless, our aim in the future is to grow this part as quickly as industry development will allow.

NRM, SC: The Islamic finance industry has got to this stage because adaptation has worked. A degree of closeness to conventional finance was necessary in the beginning to ensure customers understand the products and it has brought us this far.

We must now decide how to take the industry to the next level. It seems the view is to detach a little and differentiate ourselves. The way to achieve this is by making it widely known that Islamic finance is not a subset of socially responsible finance or impact investing; in fact, Islamic finance is the confluence of SRI, ESG and sustainable finance, and these concepts are inherent in this form of financing.

The demonstration effect is also vital. We only touched briefly on the IFFIm Vaccine Sukuk: this issuance was arranged by the World Bank, not a Muslim country, it had a social purpose and it was a resounding success. The investor profile of the subscribers was diverse; it cut across all the boundaries. These kinds of success stories do a great deal to further the cause.

SC,DDCAP: From the perspective of DDCAP, the take-away is the need to continue to concentrate on joining up the growing footprint of Islamic finance. There is a need to make a concerted effort to increase and support educational programmes, so awareness and knowledge in the nascent markets can be elevated to the required levels as quickly as possible.

Beyond my work at DDCAP, I will certainly communicate the thought leadership aspects we have discussed here to my other spheres of work at TheCityUK, at UEL and also with the RFI. My aim, in this

respect, is to help to join the dots as far as our industry collaborations are concerned.

Finally, in terms of the development of Islamic finance in the UK, I am going to continue to encourage more focus on social impact bonds and refer that discussion to other authorities, where appropriate. I think social impact certainly needs to be on the UK's Islamic finance agenda, as well as the agendas of everybody else!

GMA, AIAMSB: I have learned a lot today, especially relating to the many ways in which Islamic finance can be used for good. The numerous projects that Izani mentioned, which have a social component built in and reflect the inherent values of Islamic finance, are very interesting and important.

> *"It should be communicated that Islamic finance is universal in nature, bringing fairness, ethics transparency, sustainability, and, most importantly, profit"*

As a result of this discussion, I am certainly going to speak to our clients about providing the leeway that will enable us to undertake step-down sukuk financing! If we were given permission to invest 3 per cent of the portfolio along socially responsible lines, for example, we could begin to fund these kinds of initiatives.

Moreover, as the wealth management side of Islamic finance grows, there will be a number of clients with whom institutions have a strong personal relationship and this will provide the space for more complete explanations of the concepts that underlie sukuk issuance. Once it is clarified that sukuk is not only about profit, but also about creating a fairer society, I think there will be increased interest.

MIG, Khazanah Nasional: The most important thing is that the participants here today actually do something as a result of this discussion. We must take action in order to move the industry forward. What I have learned over the years is that the catalyst for taking action is passion, but in order to see your plans come to fruition you must also have patience.

RAAK, IILM: We must create and foster a greater understanding of the specificities of Islamic finance. It is all very well to talk about the history of the industry, but it will not develop if the details are not seriously considered. That is how we can differentiate ourselves.

MS, IFSA: Primarily, it should be communicated that Islamic finance is universal in nature, bringing fairness, ethics, transparency, sustainability, and, most importantly, profit.

In terms of the role of financial regulators: neutrality is not enough. They must provide the infrastructure for Islamic finance to develop and, where possible, incentives to stimulate industry growth.

Lastly, the aim of any government effort to promote Islamic finance must be acutely and continuously informed by the needs of the people.

CCL, Cagamas: I will confine my comments to the sukuk space. Although sukuk and bonds are quite similar in nature, we must ensure that the differences are made clear to investors. Moreover, we must make significant inroads into untapped markets in order to advance the development of Islamic finance and sukuk.

The other point is related to the practicalities of sukuk issuance. We must find a way to encourage potential issuers to opt for sukuk over conventional bonds. One of the critical issues inhibiting sukuk development is the availability of suitable asset classes on which the issuance can be based, especially for structuring globally accepted Sharia instruments. This must be addressed.

The answer could be to establish an entity that can provide such facilities, but, whatever the case, it would be very helpful if regulatory bodies could increase their focus on encouraging more sukuk issuances and resolving the dearth of underlying assets.

DVA, INCEIF: That is a very interesting discussion, but unfortunately it will have to wait for another day. It has been a real pleasure to chair this Roundtable. I look forward to continuing these discussions with you all in the future. Thank you very much indeed.

DDCAP Group

ISLAMIC CAPITAL MARKET GROWTH IN EUROPE

The UK has witnessed continuous development of a strong Islamic capital market. Europe is now following suit and seeking to expand its Islamic finance footprint.

London is an important centre for the growing sukuk market

The DDCAP Group positions itself as an intermediary in the Islamic financial services industry, providing structuring support, trade execution and value-added services to clients across the globe

THE ISLAMIC FINANCE MARKET

The Islamic financial market has continued to outgrow its conventional counterparts, even during the global economic slowdown. The worldwide demand for Islamic financial services, measured by Sharia-compliant assets, increased by 12 per cent in 2014 to reach a record US$2 trillion, tripling since the 2007 to 2008 period, despite the effects of the 2008 Financial Crisis (see fig. 1).

Indeed, the demand for Islamic capital market products, such as sukuk, is predicated on investors' desire for a more resilient alternative to conventional finance offerings, which many posit led to the 2008 Financial Crisis. As a result, banks and other financial institutions have been subsequently compelled to diversify and extend the list of securities deemed eligible by regulators for inclusion in their liquidity buffers.

Within this context, sukuk have recently played an increasingly active role in the Islamic finance space. This trend is, to an extent, a result of the increasing demand and interest from sovereign issuers, multilateral agencies and corporations seeking to diversify their financing needs and manage liquidity more effectively. Investors and issuers now view sukuk issuance as a platform to manage liquidity, provide asset and infrastructure financing in the real economy, and as a means of ensuring portfolio diversification to potentially achieve a certain degree of insulation from the volatility of other asset classes.

Over the last three years, the Islamic capital market sector has been dominated by sukuk in real terms, with their issuances surpassing US$100 billion and the addition of sovereign issuers from both Muslim and non-Muslim jurisdictions.

Regarding issuance statistics, the first ijara sukuk issued outside the Islamic world was by the UK government in 2014 in the amount of GBP200 million, followed by issuances from the governments of Luxembourg of EUR200 million, Senegal of XOF100 billion, Hong Kong of US$1 billion and South Africa of US$500 million. The vast majority of sukuk issuances remain in the sovereign and quasi-sovereign domain. However, there are strong indications that, with increasing awareness, the market will also anticipate demand from the corporate sector, including in Europe, where overall liquidity has been tightened in the conventional markets, with other forms of funding re-appraised as a result.

Unsurprisingly, the traditional sukuk markets of Malaysia, Saudi Arabia, Bahrain, and Dubai, which have been somewhat subdued in recent years, still represent, collectively, the highest levels of sukuk issuance in the world. Notably, Dubai has recently surpassed Malaysia in sukuk issuance, largely due to the Malaysian central bank's, Bank Negara Malaysia (BNM), decision to stop issuing short-dated sukuk, or sukuk with up to three-month maturities. This was based on BNM's belief that there was sufficient liquidity in the country's Islamic capital markets.

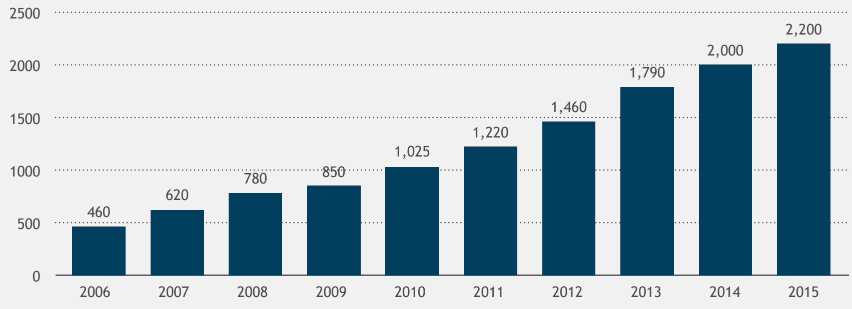
Their issuances, moreover, were being primarily used by foreign banks to manage their liquidity needs, and therefore, doing little to improve the liquidity needs of the domestic market. According to Standard & Poor's, this reduction in issuance by BNM resulted in a 42.5 per cent reduction in the global value of issuances in the first half of 2015 compared to the same period in 2014. Nonetheless, given the growing familiarity and utilisation over different jurisdictions, sukuk are likely to become a key component of the financial landscape in both developed and emerging markets.

GROWTH IN THE UK AND EUROPE

Historically, the speed of development of the Islamic capital market in terms of sukuk issuances has generally been driven by the dominant jurisdictions of Malaysia and member states of the Gulf Cooperation Council (GCC). In recent years, there has been a gradual and sustained effort in Europe to promote Islamic finance, particularly in the UK, Luxembourg and Ireland.

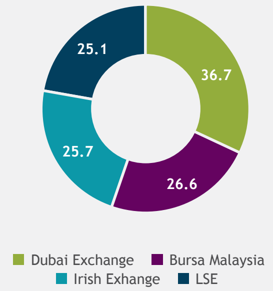
In this regard, the UK has arguably been the most pro-active, due in part to London's pre-eminent status and role in global finance.

1. GLOBAL SHARIA-COMPLIANT ASSETS (US$ IN BILLIONS)



Source: TheCityUK Islamic Finance Report 2015

2. OUTSTANDING GLOBAL SUKUK BY EXCHANGE AS OF JUNE 2015 (US$ IN BILLIONS)



Source: Nasdaq Dubai Report

Additional factors include the UK's historical links with the core Sharia finance markets of the GCC and Malaysia, as well as its requirement to meet the needs of the country's own Muslim population. The UK was recently identified as an important destination for Islamic finance, receiving an index value of 16.2 in the 2014 ICD Thomson Reuters Islamic Finance Development Report, well above the global average of 10.3. This figure represents the value given to important global centres of Islamic finance based on their offerings in terms of education and research, governance, corporate social responsibility and awareness. The UK was the highest ranked non-majority Muslim country.

The sukuk market is an essential part of the Islamic finance market, and London, as a major hub for international bonds, is an important centre for the issuance and trading of sukuk. The outstanding value of international bonds issued in the UK at the end of 2014 was US$3.3 trillion, representing approximately 15 per cent of the global total, second only to the U.S. London is also the leading centre for international bond trading with an estimated 70 per cent of secondary market turnover.

As the first Western sovereign to issue, in 2014 the UK government sold GBP200 million of sukuk with a 5-year maturity and profit rate on the sukuk set at 2.036 per cent, in line with the yield on conventional gilts with similar maturities. This debut sovereign sukuk was oversubscribed by a factor of eleven, with strong demand and orders amounting to approximately GBP2.3 billion from both domestic and international investors. The sukuk was allocated broadly with investors, including central banks, sovereign wealth funds, and local and foreign financial institutions. It was listed on the London Stock Exchange (LSE), which is a key global venue for the issuance of sukuk, having been involved with 57 listings with a total value of US$51 billion. In terms of global sukuk listings, a Nasdaq Dubai report revealed that in June 2015, there was a change in the dynamics of their listings in the traditional centres of Malaysia, Ireland and London. Accordingly, Dubai's two exchanges, Nasdaq Dubai and Dubai Financial Market, registered total current listings of US$36.7 billion, ahead of Malaysia's Bursa Malaysia and the Labuan free trade zone listing US$26.6 billion, the Irish Stock Exchange (IE) totalling US$25.7 billion, and the LSE with US$25.1 billion respectively (see fig. 2).

The UK government issued its sovereign sukuk with a number of objectives in mind. One objective was to open up alternative sources of funding at an all-in cost equivalent to conventional gilts, thereby ensuring value for money to the UK public and taxpayer. Another objective was the provision of a High Quality Liquid Asset (HQLA), which could be utilised by domestic Islamic banks as part of their regulatory liquidity and capital requirements. A further objective was to set a precedent that demonstrated to the corporate sector that the UK had implemented a proven platform and infrastructure to enable sukuk to be issued comparably to conventional bonds.

As a result, this now paves the way for sukuk to become an instrument of choice for raising corporate finance. This process has been a work in progress in the UK for more than 15 years and has been supported with a programme of legislative reform targeted at providing a level playing field for Islamic financial instruments.

Thus, two major developments followed shortly after the UK sovereign sukuk issuance. The first was seen as a key milestone in the annals of sukuk development in the UK, as UK Export Finance (UKEF) announced the provision of guarantees for Sharia-compliant financings involving British exporters. In March 2015, it was announced that UKEF would provide a guarantee in support of the US$913 million sukuk issued by Dubai's Emirates Air Line. This was a 'triple first' in its own right. Not only was it the first instance of sukuk certificates being guaranteed by an export credit agency (ECA); it was also the largest debt capital markets offering, conventional or Islamic, in the aviation sector, with an ECA guarantee to date; and, finally, it was the first time that sukuk had been issued to raise finance prior to delivery of an aircraft. This has had a demonstrable effect on the issuance of buyer credits, with ECA providing backing for exporters wishing to offer medium-term funding to markets within member states of the Organisation of Islamic Cooperation (OIC) as part of their overall project bids. Given that the UKEF guarantee ranks alongside that of the UK government, this issue further reinforced the commitment of the government to deepen the Islamic capital market, by encouraging regular or recurrent issues by major European and international issuers.

The second development was initiated in late 2014 by means of further innovation. This involved the International Finance Facility for Immunisation (IFFIm) tapping the international capital markets to raise finance in order to accelerate the availability of funds for immunisation programmes and health systems via the international organisation Gavi, the Vaccine Alliance.

IFFIm currently has nine sovereign donors, including the UK, which has pledged GBP1.63 billion, or 46 per cent of total pledges over a 23-year period. In addition to the UK, several other European governments have contributed donations. In late November 2014, IFFIm issued its inaugural sukuk, raising US$500 million for Gavi. Deemed to be the first benchmark-sized sukuk primarily focused on social impact, it provided institutional investors with a socially responsible investment opportunity that will help vaccinate and protect tens of millions of children against preventable diseases. This sukuk was listed on the LSE and was oversubscribed, with global interest shown from multiple investors.

A supportive architecture underpins the UK Government's ambition to become a key global player and leader in Islamic finance in the Western world, acting as an enabler to ensure this objective is realised. For example, the presence of numerous leading law firms and professional service companies based in the City of London, which specialise in all aspects of Islamic finance, has greatly added to the UK's ability to offer advisory and structuring services to Islamic financial market participants around the world.

Notwithstanding the UK's long established position, Europe has become an important listing destination for international sukuk, for both Asian and Middle Eastern issuers, who are seeking to widen their investor base and simultaneously promote secondary market activity in sukuk markets outside their domiciled countries.

This feature has often been absent from sukuk markets in industry hubs, where the securities tend to be held to maturity. European exchanges including the LSE, the IE and the Luxembourg Stock Exchange have been able to attract Islamic issuers by offering efficient and transparent listing processes and market liquidity profiles.

Regarding funds, Europe has seen a steady growth of Islamic funds domiciled within the EU. There were approximately US$14 billion in Assets under Management (AUM) in the EU as of 2014, according to the Malaysia International Islamic Financial Centre's report on Islamic Finance in Europe. This accounts for approximately 20 per cent of the global aggregate of Sharia-compliant AUM, up from 12 per cent in 2012.

Generally, the appeal of European domiciles for fund management lies in the attractive combination of tax benefits, regulatory sophistication, operational efficiency and diversification. Each of these factors contributes to the universe of choices for fund and asset managers seeking to satisfy their customers' preferences. More importantly, in cases where these factors are lacking in other asset managers' immediate local or regional markets, European markets offer an advantageous alternative for their investment portfolio needs.

Accordingly, traditional fund management domiciles in Europe, such as Luxembourg, the Channel Islands and Ireland, have tended to be among the favoured locations for the incorporation of Islamic funds and offer the provision of ancillary services for local regulatory requirements. The distribution of many of these funds has largely come from London and other core, Islamic financial hubs, in which there is extensive experience from local and international firms available to ensure successful distribution on a global basis.

CONCLUSION

The future development of the sukuk fund market, from a European perspective, will certainly depend on the volume of new, global sukuk issuance by all types of market players including sovereign, supranational and corporate issuers. However, given the ever-growing cross border reach and sukuk becoming mainstream in Europe, as a result of the enabling financial architecture that is already in place or in development, the prospects of further issuance, listings and wider market development is promising. The Islamic capital market and its sukuk funds subsector have traditionally been referred to as, predominantly, a feature of the Southeast Asian and GCC markets. There are now growing signs that both are finding a complementary and expanding platform in Europe.

Moreover, in the UK and across Europe, the demand for infrastructure development continues to grow rapidly and the requirement for alternative and efficient sources of funding for significant national projects is a priority agenda item. This has resulted in the Islamic financial industry becoming an important and growing focus of numerous international governments.

In the UK, Islamic finance has already played an important role, as illustrated by its inclusion in the financing arrangements and solutions utilised in the development of infrastructure and infrastructure-related projects around London. For example, it has been used to provide development finance for The Shard, London Gateway and the Olympic Village, as well as the re-development of Chelsea Barracks and regeneration of Battersea Power Station.

Islamic finance is a core work stream of the UK Financial Services Trade and Investment Board (FSTIB) established by the Chancellor of the Exchequer in 2013. Consequently, TheCityUK, which sits on the board of the FSTIB, inaugurated the Islamic Financial Market Advisory Group in 2014.

Chaired by DDCAP Managing Director Stella Cox, the group is tasked with providing a central point for UK thought leadership in Islamic finance. Currently, the domestic footprint of the projects deemed relevant to Islamic investment and funding is growing. With the proactive support of the UK government, it is ultimately likely to result in the country's Islamic capital markets providing a financial platform for regeneration, development and project funding across the United Kingdom.

ABOUT THE DDCAP GROUP

The DDCAP Group was founded in 1998 and is headquartered in central London, with a presence in the Middle East. The group is majority-owned and controlled by IPGL Limited, which is a private holding company focused on partnering with experienced management teams to build fast growing business in financial services and other sectors. DDCAP Limited (DDCAP) positions itself as an intermediary in the Islamic financial services industry, providing structuring support, trade execution and value-added services to clients across the globe. Its primary markets include the GCC, Southeast Asia, Europe and the US.

Through its unique position in the market, DDCAP is able to provide physical asset facilitation services to over 300 third-party institutions including central banks, government institutions, Islamic banks, conventional banks and managers of Sharia-compliant funds. Additionally, its wholly owned merchant trading company subsidiary, DD&Co Limited (DD&Co), has originated commodity for a large number of structured and syndicated transactions for entities in various jurisdictions, including Dubai, Hong Kong, Kuala Lumpur, London and Riyadh.

DDCAP's multi-award-winning Asset Facilitation Platform allows its customers to purchase commodities via a secure electronic portal as an alternative to the other transactional methods that remain available. The platform is functional 24 hours a day to resolve the time zone issues faced by customers across numerous jurisdictions.

In addition to being approved by DDCAP's own Sharia Supervisory Board (SSB), it has also been endorsed by other internationally recognised Sharia scholars. SSB is comprised of esteemed Sharia scholars including its chairman, Sheikh Abdullah Bin Suleiman Almaneea, Sheikh Dr Abdullah Almutlag and Sheikh Dr Mohamed Ali Elgari. In September 2015, DDCAP was proud to announce the additional appointment of leading Malaysian scholar and professor Dr Mohamad Akram Laldin to the DDCAP SSB, reflecting DDCAP's ever-increasing footprint in Southeast Asia.

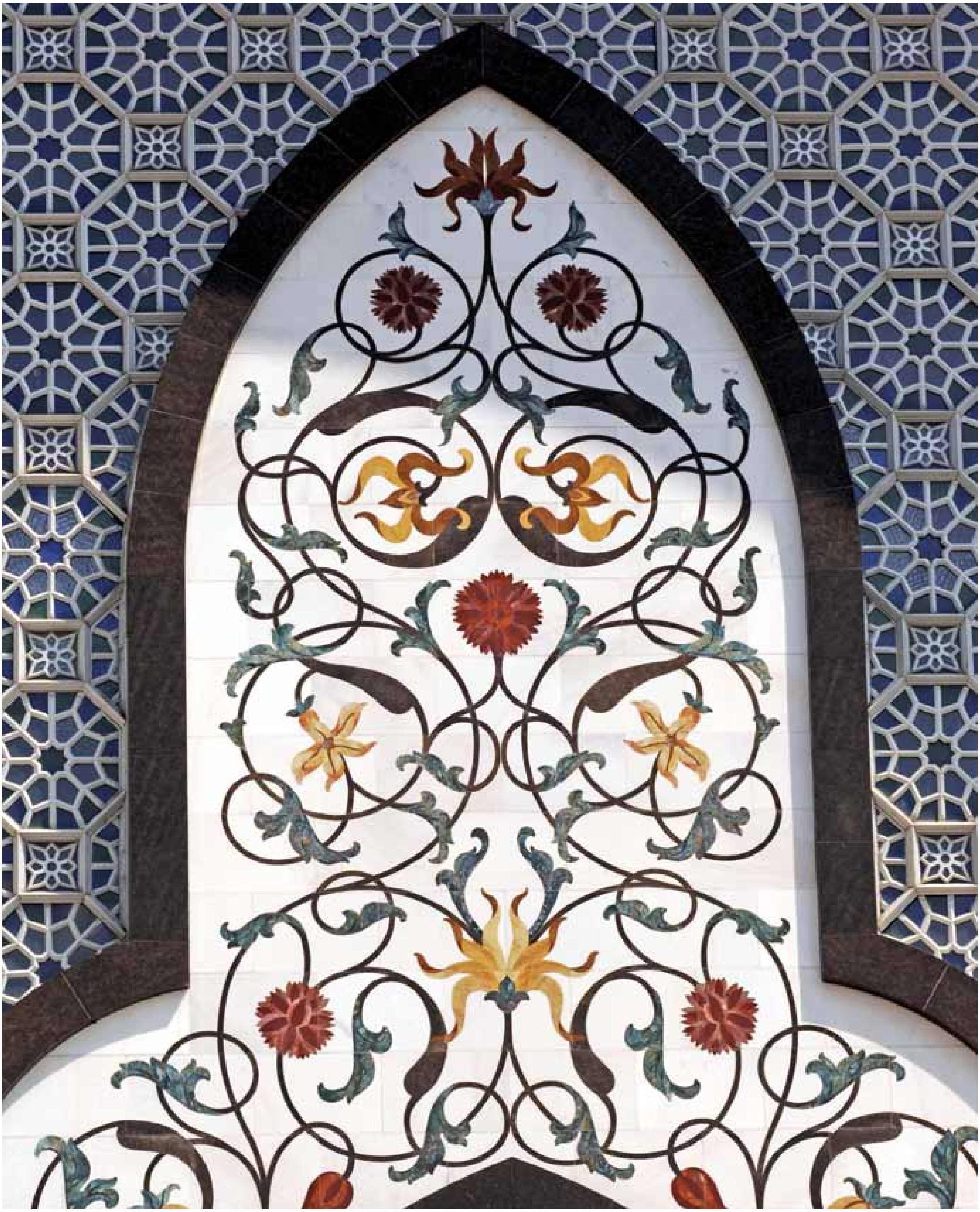
STELLA COX
Managing Director

DDCAPResearch@ddcap.co.uk

DDCAP Limited

8-10 Grosvenor Gardens
London SW1W 0DH
UK

+44 207 863-1250
www.ddcap.co.uk



PERSPECTIVE: STIMULATING PRIVATE SECTOR SUKUK MARKETS

The impressive growth of Islamic finance in recent years has been spurred on by significant rises in global sukuk issuances. Despite the clear gains, underdevelopment in private sector sukuk markets must be addressed by the industry and will require substantial reform.

Michael J.T. McMillen, partner at Curtis, Mallet-Prevost, Colt & Mosle LLP and Adjunct Professor of Law at the University of Pennsylvania Law School, reflects on corporate sukuk market development

THE STATE OF SUKUK

The success story of Islamic finance since 2002, and particularly since the 2008 Financial Crisis, is the growth and resilience of the sukuk markets, which are the largest component of the Islamic capital markets.

Global sukuk issuances from 2002 until 7 November 2008 totalled US$88 billion; issuances bottomed out at US$38 billion in 2009, surged to US$140 billion in 2012, and then plateaued at US$116 billion in 2013 and 2014. The final figure for 2015 is expected to decrease to approximately US$55 billion, due to the discontinuance of short-term sukuk issuance by Bank Negara Malaysia (BNM). Historically, BNM has accounted for almost 40 per cent of total global sukuk issuances.

In 2014, sovereign issuances comprised 63 per cent of the total global market, with corporate issuances making up 22 per cent, and quasi-sovereign issuances 16 per cent. In fact, these figures reveal little about the true state of the markets and may be misleading. For example, the 'corporate' category includes issuances by corporates based in Malaysia, financial institutions and supranational bodies, such as the Islamic Development Bank (IDB) and Islamic Liquidity Management Corporation. In 2014, issuances from Malaysian institutions constituted 69 per cent of the total.

Globally speaking, there are only a handful of non-financial corporate issuances outside Malaysia and corporate issuances are primarily from Malaysian and Turkish financial institutions. Additionally, a sampling of 'corporate' issuances revealed that a significant number were ultimately dependent on revenues from a sovereign entity. In all cases, parsing the information is difficult because of the absence of transparent, detailed reporting. Classification criteria are not revealed and categories are not subdivided or broken down into constituent elements. In short, detailed information is not freely available and opacity is increasing.

To summarise the situation, essentially all sukuk are sovereign or ultimately dependent on sovereign credit. Moreover, there have been very few non-financial private sector sukuk issuances, clearly highlighting that, the private sector is not realising the benefits of sukuk. Without diminishing the contributions that sukuk have made to sovereign infrastructure development, an appropriate conclusion is that there are gaps in the sukuk success story and the Islamic finance industry must proceed with the arduous undertaking of developing private sector sukuk issuance.

This piece seeks to identify some of the critical factors that must be addressed in order to close the gaps and develop private sector sukuk issuance. Three categories of critical factors are considered: bankruptcy, within which the issues relating to special purpose entities (SPEs), true sales, and substantive consolidation are considered; collateral security; and systemic legal structures, processes and procedures.

CONTEXT

Two fundamental topics that inform an understanding of the aforementioned critical factors are the nature of sukuk and the necessity of ratings, which are the primary determinant of marketability of private sector sukuk.

SUKUK AS SECURITISATIONS

It cannot be overemphasised that sukuk are securitisations, not bonds, which, simply put, are usually obligations payable out of the issuer's general revenues regardless of profitability. The widespread practice of referring to sukuk as 'Islamic bonds' confounds the discussion and directs it away from rigorous inquiry regarding the critical factors impeding private sector sukuk markets.

Sukuk may be structured as securitisations of a single asset, a pool of assets, or a whole business, in each case using different structures and contracts. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), in its widely-accepted Sharia Standard No. 17 - Investment Sukuk provides for 14 permissible sukuk categories by asset class and activity using nine different contracts.

RATINGS

The critical factor in developing a private sector sukuk market is the ability to have the private sector issuer or issuance rated by an international rating service. Ratings services publish and apply a myriad of detailed ratings criteria that relate to specific assets, structures and entities. Ratings principles apply to all types of corporates, governments, securitisation structures and asset classes. Specific methodologies and assumptions apply to certain types of issuers, issues, asset classes, markets and regions.

Standard & Poor's Ratings Services has published criteria setting forth its methodology for rating sukuk. Indicative of the lack of true securitisation sukuk, this methodology relates exclusively to structures involving sponsor, usually originator, contractual support for periodic payments by the SPE issuer of and on the sukuk, as well as the repurchase of the securitised assets on maturity of the sukuk. While this structure is pervasive in current sukuk markets for both sovereigns and financial institutions, it is of limited assistance to private sector issuers, whose entity credit is inadequate to achieve higher ratings.

There are five key areas in the analytical framework for structured finance securitisation ratings: the credit quality of the securitised assets; legal and regulatory risks; payment structure and cash flow mechanics; operational and administrative risks; and counterparty risks. The focus of this piece is on some of the critical legal and regulatory risks, such as bankruptcy matters and, in certain transactions, collateral security matters. In each case, the ratings service seeks to obtain comfort regarding these risks, and others, by obtaining the appropriate legal opinions.

LEGAL OPINIONS

Obtaining satisfactory legal opinions on critical aspects of the securitisation is critical to securing the rating, as well as satisfying a transactional closing conditions precedent. The opinions are usually rendered by the issuer's outside counsel or opposing outside counsel and include third-party opinions. This practice is intended to assure the independence and integrity of the opinions, including through due diligence inquiries.

There are four general categories of required legal opinions, each rendered under the relevant applicable law. The two of relevance here are opinions addressing the validity, binding effect and enforceability of the relevant documents, termed 'enforceability' or 'remedies' opinions; and specific matters of substantive law, such as, true sale, substantive consolidation, liens, fraudulent conveyances, and others.

A remedies opinion addresses issues relating to whether the provisions of an agreement will be given effect by the courts. The essence of the opinion is that each of the contractual 'undertakings' is enforceable. The undertakings are: the 'obligations' provisions; the 'available remedies' provisions; and the 'ground rules' provisions. The standard wording of the opinion is that, "the agreements are valid and binding obligations of the [entity], enforceable against the [entity] in accordance with their terms", although there are likely to be exceptions to this generalised statement.

This opinion is delivered to specific transaction parties and some third parties, such as a ratings service, and only addressees may rely on the opinion. The remedies opinion covers three distinct, but related, matters: it confirms that an agreement has been formed; it confirms that the remedies provided in the agreement will be given effect by the courts; and it describes the extent to which the courts will enforce the provisions of the agreement that are unrelated to breach.

Private sector sukuk transactions also include legal opinions addressing the following matters, among others: SPE considerations; true sale of securitised assets; lien-free transfer of assets; non-consolidation of assets in bankruptcy; the collateral security structure; enforceability of transactional documents; choice of governing law; enforcement of judgments and awards; tax status of the SPE; fraudulent conveyances; and preferential transfers. The ratings services have specific requirements pertaining to some of these matters.

BANKRUPTCY

SPECIAL PURPOSE ENTITIES

The first bankruptcy-related critical factor relates to SPEs. The focus of a ratings service is whether the entity that owns, or holds, the payment rights (securitised assets) and is obligated to make payments on the sukuk is 'bankruptcy remote', meaning that it is unlikely to be involved in either a voluntary or involuntary bankruptcy proceeding.

The criteria used to make the bankruptcy remoteness determination focus on six characteristics, each of which must be addressed in either or both the organisational and transactional documents. The fundamental characteristic is that the SPE's objects and powers are restricted to ensure that it performs only the bare activities necessary to effect the sukuk transaction and not others that might give rise to claims of persons or entities that are not sukuk holders. There should also be limitations on SPE indebtedness and sponsor bankruptcy filings to minimise the likelihood that creditors and sponsors may cause SPE involvement in a bankruptcy proceeding.

Additionally, the entity should have an independent director, or equivalent, whose vote is required for filing of voluntary bankruptcy petitions and certain other matters to avoid interlocking directorates and reduce the likelihood of such petitions; there should be prohibitions on merger, consolidation and similar transactions to provide comfort that the SPE's bankruptcy-remote

There have been very few non-financial private sector sukuk issuances, clearly highlighting that the private sector is not realising the benefits of sukuk status will not be undermined by these transactions; and the entity should agree to abide by certain separateness covenants to provide comfort that the SPE will act independently, which reduces the likelihood of a court 'piercing the corporate veil', characterising the SPE as an 'alter ego' of another entity, or invoking 'substantive consolidation' concepts. Finally, security interests in securitised assets should have been created to reduce incentives of parent entities, parent creditors and other SPE creditors to file the SPE into bankruptcy.

TRUE SALE

It is often observed that defining 'true sale' is the holy grail of the securitisation market. In private sector issuances, it is necessary to demonstrate that there has been a true sale of the securitised assets. The inability to make the true sale demonstration or to obtain the related legal opinion supporting a true sale are the leading inhibitors to private sector sukuk market development. A complexity is that there are slightly different true sale principles under bankruptcy, collateral security, and tax laws, and more than one set of rules may have to be satisfied.

True sale relates to the nature of the transfer of the assets from the asset originator to the SPE that issues the sukuk. The essence is whether, in an originator bankruptcy, a creditor of that originator will have recourse to the assets that underlie the sukuk. If the SPE owns the assets, i.e. there was a true sale, the sukuk holders will be repaid out of those assets in accordance with the terms of the sukuk and the originator bankruptcy will be inconsequential to the sukuk holder.

Substantive legal reform of bankruptcy laws in OIC countries is vital in order to stimulate private sector sukuk

Failure to establish a true sale results in an inability to obtain a true sale legal opinion and, in turn, a rating. If a true sale is absent, the rating will be based on the rating of the originator as obligor, taking cognisance of all its liabilities and competing creditors. The assets, although held by the SPE, will be considered those of the originator, and the issuance will be treated not as 'asset-backed', but as 'asset-based'. Thus, the sukuk holders will be deprived of their payment streams and the securitised assets.

The critical issue is whether the SPE has assumed sufficient risks relating to the value, and the burdens of ownership, of the assets. To the extent that the originator continues to participate in asset value, the risks assumed by, and the true sale position of, the SPE are diminished. Among the many factors considered in a true sale analysis are whether or not the originator has an interest in either or both the cash flows and the residual value of the asset, and whether or not the originator may reacquire the asset at other than fair market value at the time of reacquisition. If the originator has such rights, the transaction is probably not a true sale and the sukuk holders are at considerable risk of sacrificing their payment stream to a creditor of the originator.

Most contemporary sukuk fail the true sale tests. Repurchase obligations at other than fair market value are commonplace, as are violations of other true sale criteria. While this is of little consequence in sovereign offerings, and of lesser consequence in financial institution offerings, it is fatal to the development of private sector sukuk markets.

The situation is dire in most jurisdictions within the Organisation of Islamic Cooperation (OIC). Bankruptcy laws are relatively rudimentary in most OIC member states and are insufficient in terms of true sale and similar concepts. Even if the transactional structure complies with rigorous true sale principles, lawyers are unable to render true sale opinions because the substantive law of true sale is insufficiently developed. Thus, substantive legal reform of bankruptcy laws in OIC countries is vital in order to stimulate private sector sukuk.

Before moving on to the next concept, due to the industry interest in the topic, the distinction between asset-backed and asset-based structures, referred to above, is worth further consideration. In a properly structured sukuk transaction involving an asset transfer that is not a true sale, but that includes a first prior perfected security interest or security right in the transferred asset, the asset ownership transfer is postponed, pending the occurrence of a default or other event or circumstance that allows realisation upon the security interest or security right. The asset-based arrangement becomes an asset-backed arrangement if the default, event or circumstance occurs. If it does not, the transaction runs its course and the analytical focus shifts to how the sukuk is retired, and whether the sukuk retirement effects a transaction that is equivalent, for Sharia purposes, to an impermissible repurchase of the asset by the originator at something other than fair market value at the time of the transfer.

SUBSTANTIVE CONSOLIDATION

Another set of bankruptcy considerations is subsumed in the amorphous 'substantive consolidation' concept. This is the judicially imposed equitable remedies concept that two or more legally distinct entities might be combined into a single debtor with a common pool of assets and a common body of liabilities, with the third-party liabilities of the subject entities being satisfied from the single asset pool. Substantive consolidation might occur even if asset transfers into an entity were true sales. In the sukuk context, the entities that might be substantively consolidated are the originator and the issuer SPE.

Substantive consolidation significantly affects creditors and their recoveries. It effectively denies them the benefit of their bargain and their freedom of contract to obtain that bargain: a transaction based on risk assessments, and risk and monetary allocations, that are premised on recourse to the assets of a specific debtor in competition only with other permitted, and limited, creditors of that debtor. It abrogates asset partitioning concepts and limited liability concepts, as well as structural subordination.

A condition to rating is a legal opinion to the effect that there will be no substantive consolidation. That opinion is essentially impossible to render in most OIC jurisdictions, given the state of development of the law. It is frequently impossible even to determine if the concept exists, let alone parse the nuance of when the concept might be applied. This should also be an area of focus for structural legal reform initiatives, if sufficient clarification is to be achieved for purposes of obtaining ratings on private sector sukuk.

COLLATERAL SECURITY

Some securitisation transactions involve collateral security elements, such as mortgages, security interests or security rights, because they are structured to involve one or more transactions that are not true sales. For example, it may be uneconomic, impermissible or imprudent to transfer the title to an asset from the originator to the SPE at transactional inception, due to high tax impositions, restrictions on transfers of certain types of property, legal requirements to inform every obligor on the transferred assets, and other constraints. Or the relevant security interest laws may mandatorily encompass the securitised assets.

In an asset transfer to the SPE, the granting of a security interest in the assets that serve as collateral for the sukuk will not provide adequate comfort that the sukuk will be paid in a timely manner or receive the full value of the collateral if the originator-transferor becomes involved in a bankruptcy proceeding. For example, in the instance of an automatic stay, or a similar process, which would delay payments, the originator may be permitted to use the assets in a sale or as collateral for another financing, or the SPE may be required to return the assets to the originator's bankruptcy estate.

The customary structural protection against this is the appropriate use of one or more SPEs. Additionally, the ratings services and the opining legal counsel will analyse each asset transfer in the structure to determine if it is a true sale, a secured loan or something else; the nature of each party's property rights in the assets; and whether any entity that is unrated or not bankruptcy remote retains any interest in those assets. True sale opinions are usually required for at least the initial transfer to an SPE. If the assets are involved in subsequent loan arrangements and serve as collateral, for example in multi-tier structures, security interests or rights must constitute first prior perfected security interests or rights, and legal opinions will be required with respect to those interests or rights.

Collateral security laws are significantly underdeveloped in most OIC jurisdictions and lawyers have generally been unable to render opinions as to SPE status and perfection and priority of security interests or rights that are necessary to obtain ratings on sukuk. While such ratings have been unnecessary for sovereigns, quasi-sovereigns and financial institutions to date, they will be critical for private sukuk market development.

Efforts are already being made to develop collateral security regimes for OIC jurisdictions. Examples include the laudable efforts of the United Nations Commission on International Trade Law (UNCITRAL), the European Bank for Reconstruction and Development (EBRD), and the World Bank. Each is examining the modification of its model laws in order to be Sharia compliant, while also remaining in harmony with modern international practices. This is encouraging from a long-term perspective and it may provide some short-term guidance to jurists, even prior to the adoption of these laws in the longer term.

SYSTEMIC FACTORS

The general structure, processes and procedures of the relevant legal systems, termed here 'systemic factors', are relevant to development of private sector sukuk due to the effect they have on the predictability and certainty of designated outcomes, as well as the ability of counsel to render legal opinions. Systemic factors affect ratings, pricing, and a panoply of risk-related business matters. At present, predictability and certainty are relatively low for these matters.

There are a number of deficiencies in the systemic factors of particular jurisdictions. They include the permissibility of *ex post facto* legislation; the fact that Sharia is comprised of general principles, rather than specific requirements, and that application in specific transactions is difficult to determine; issues relating to inconsistency and interpretative differences between Islamic jurisprudence schools regarding particular Sharia principles; a lack of transparency as to the Sharia principles as a result of the foregoing factors and the infancy of modern Islamic finance; a lack, or often absence, of binding precedent concepts and published decisions with their rationales; *de novo* consideration of each case and each issue set without regard to other determinations; a great degree of discretion in courts in these jurisdictions; and a number of uncertainties regarding the availability and application of remedies.

Moreover, additional systemic factor deficiencies relate to the application of choice of law principles being unclear and uncertain; the unwillingness to enforce foreign judgments and foreign arbitral awards, and related questions regarding whether Sharia law may constitute a public policy exception to enforcement; and, finally, the significantly extended time frames for determinations of disputes and enforcement of remedies, which are often so long as to preclude effective remedies.

There are a number of deficiencies in the systemic factors of particular Islamic finance jurisdictions

The lack of certainty and predictability that result from these deficiencies often precludes the rendering of necessary legal opinions, the willingness of ratings services to provide ratings, and the markets from accepting unrated products, such as private sector sukuk.

SUGGESTIONS

The prospect of developing private sector sukuk markets may seem daunting, given the substantial reform needed. However, I am not of the opinion that Islamic finance stakeholders should forsake all hope until both substantive and systemic reforms have been implemented, which could take years, if not decades.

Accordingly, I will make two suggestions regarding how to proceed. The first entails formal and informal initiation of coordinated programmes for substantive legal and systemic reform. Admittedly, this is a longer-term and more arduous undertaking that requires coordinated political, social, legal and religious efforts.

The second suggestion involves a change in vision and orientation, and seems achievable in the near term. I propose an immediate focus on private sector sukuk issuance in and from jurisdictions where ratings are currently achievable; market acceptance of securitisation is broad and deep; and other critical criteria are already satisfied. The main objective here is to prime the pump and build a large and sustainable transactional flow in the shortest possible time frame. Another objective is to provide a proving ground for the private sector. The parameters should allow accelerated achievement of both market segment growth and higher levels of product sophistication. Crucially, the initiative must be structured to serve an integrative function involving both Islamic and conventional finance.

In order to advance this proposal, it is first necessary to identify the criteria for selecting an appropriate jurisdiction. Current widespread availability of ratings for comparable arrangements is a fundamental prerequisite. A sophisticated and well-developed legal and regulatory regime and related infrastructure are critical foundation elements. A large and diverse market for both securitisable assets and absorption of securitised products is important. Extensive experience with securitisation techniques and a well-developed institutional infrastructure are essential. High levels of market and technical sophistication are highly desirable. Existing liquid markets, both primary and secondary, are an imperative if the liquidity and capital issues of the Islamic finance industry are to be served. The jurisdiction should not suffer from the systemic impediments previously identified. Finally, predictability and certainty relating to critical factors should be at the highest levels with respect to all relevant factors.

Taking the criteria outlined above, my suggestion is to focus on private sector sukuk issuances from the U.S. and similar markets. The U.S. securitisation markets are massive, and support trillions of dollars worth of issuances of a variety of assets. These markets and the base of securitisable assets are broad and diverse. Rated private sector issuances are commonplace, both from individual companies and from pooling vehicles. The legal and regulatory infrastructure, the market mechanisms and the institutional frameworks are existent, developed and refined. The securitised product, in this case sukuk, can be sold and traded throughout the world. Both primary and secondary markets are highly liquid. Predictability and certainty parameters are satisfied.

The Islamic finance industry must do more than merely participate; it must lead the reform initiative

CONCLUSION

The benefits and ideals of Islamic finance mandate that more than sovereigns and large financial institutions participate in the funding opportunities afforded by sukuk. Private sector involvement is imperative, and must occur at the earliest practicable time.

Furthermore, substantive legal reform must take place in critical areas. However, this challenge may not be as daunting as it first appears: suitable models, technical expertise, and a wealth of experience exist and can be harnessed for the task. The initiatives of UNCITRAL, EBRD and the World Bank, among others, may lead the way. Sharia-compliant versions of their model laws will greatly assist OIC jurisdictions that undertake reform initiatives. Even the existence, without adoption, of compliant model laws will provide jurists with insights into resolving contemporary financing issues in compliance with Sharia, and in harmony with international practices and procedures.

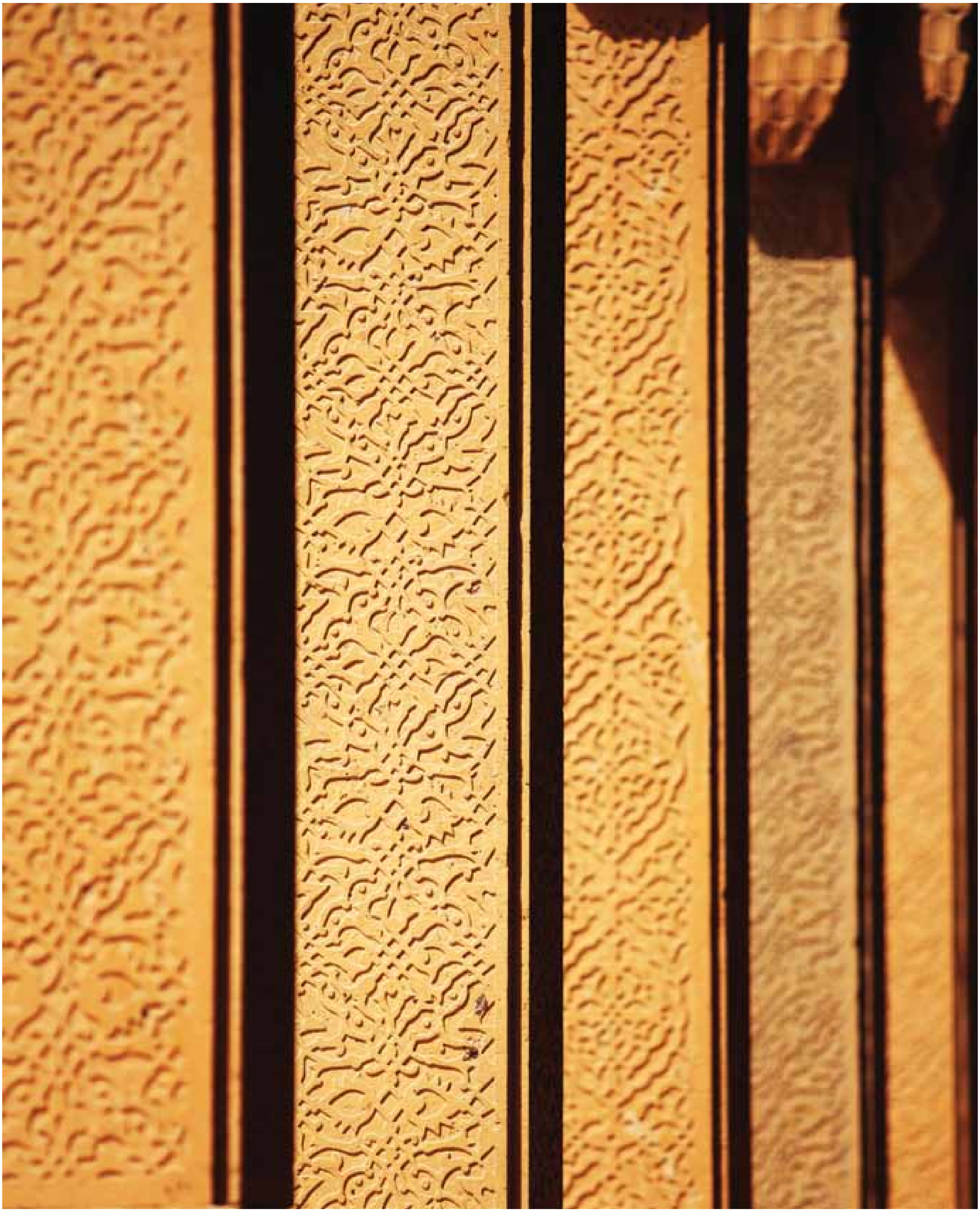
The more challenging process may be effecting change to systemic structures, processes and procedures. This will require strong, sustained and diligent leadership that is sensitive to the politically charged intrusion of the reform process on existing customs, prerogatives, sociopolitical alignments, intergroup relationships and balances, vested interests, and carefully guarded institutional fiefdoms, not to mention budgets. To date, political will and consensus have been sought with respect to substantive legal principles, but seem not to have been diligently pursued with respect to systemic reforms.

The required will, consensus and commitment are not just secular. All segments and levels of the Islamic finance industry must participate. Doctrinal standardisation should be achieved where that is feasible without denigration of legitimate religious interpretive positions. One of Islam's particular strengths lies in its diversity of thought and interpretation, and should not be forsaken for economic convenience. There are ways to achieve consensus on structural forms that accommodate divergent interpretations of principle, and efforts should be directed towards achieving this consensus. Thus, sustained cooperation is paramount. The industry has already demonstrated its cooperative capabilities, including within initiatives implemented through the IDB, AAOIFI and the Islamic Financial Services Board. Consequently, there is a greater sense of optimism with respect to potential achievements by industry actors and initiatives.

Yet, the Islamic finance industry must do more than merely participate; it must lead the reform initiative. The industry has the requisite technical knowledge and, at many levels, the position and credibility to positively influence political, social, institutional and other actors. It should seek to integrate participants and coherently shape the reform process from inception in areas such as bankruptcy and collateral security, rather than labouring over piecemeal disjunctive amendatory processes, as has so often been the case in developed areas, such as banking.

Nevertheless, the path will be long and arduous. The suggestions made in this Perspective are intended to satisfy immediate needs, while also laying the base and providing an impetus for further development of the necessary substantive and systemic reforms. There is an opportunity to tap into and harness already existing and refined securitisation markets, processes and institutions in order to make the benefits afforded by sukuk available to the private sector. This can be done at the same time as developing the liquidity and secondary market elements that have thus far eluded the Islamic finance industry. It is an opportunity that should not be neglected or squandered.

➥ Dr McMillen teaches Islamic finance at the University of Pennsylvania Law School and The Wharton School. Views expressed in this Perspective are the author's own.



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SHARIA-COMPLIANT INVESTMENT IS WORTH IT

Aberdeen Islamic Asset Management Sdn Bhd is promoting the ethical and financial benefits of Sharia-compliant investment, which have more in common with SRI than most mainstream investors realise.

Malaysia is a hub for Islamic finance

Sharia-compliant investment may offer a solid hedge against the next financial crisis

INDUSTRY PERCEPTIONS

Every single investment is a leap of faith. For many choosing to invest in Sharia-compliant products, that is especially true given their religious convictions.

In recent years, there has been a boom in demand for both equities and fixed income, such as sukuk, and the profile of Sharia-compliant products has risen. However, misperceptions remain.

First, it is often thought that performance will suffer in Sharia-compliant investments, owing to their religious component, which imposes restrictions on what securities investors may buy.

Second, a commonly held belief is that Sharia-compliant investments are only really for Muslims and therefore irrelevant for mainstream investors looking to build genuinely diversified portfolios.

Last, managers of Sharia-compliant funds are sometimes deemed to lack not only sufficient financial expertise, but also knowledge relating to Islamic practices and Sharia law.

To understand fully the advantages of Sharia-compliant investments, it is important to address these issues one by one.

COMPETITIVE PERFORMANCE

Claims that Sharia-compliant funds underperform when compared to conventional investments are not true. Comparisons between two commonly used indices, the MSCI AC Global Equity and the MSCI AC Asia ex Japan Equity and their Sharia equivalents, show that under certain conditions, the Sharia one can hold its own (see fig. 1).

Crucially, the performance of Sharia indices is largely determined by one factor: the performance of bank stocks. When bank stocks do well, Sharia indices underperform, and vice versa.

Clearly, banks are a major component within conventional indices. Yet, eight years on from the last financial crisis and regulators still concede that some banks are too big to fail; capital inadequacy remains a problem in the wake of undemanding stress tests; 'Chinese walls' are weak in the face of continuing conflicts of interest; and transaction costs for bank customers are often excessive.

Therefore, for investors who are apprehensive about the reliability and stability of conventional global banking and finance, Sharia-compliant investment may offer a solid hedge against the next crisis. In fact, had Sharia precepts operated in 2008, they may well have prevented the last one.

One of the reasons for this is because Sharia principles prohibit the paying or receiving of fixed interest. Adherence to this concept, referred to as riba, would have reduced the likelihood of speculative and risky behaviour among over-leveraged banks and insolvent borrowers in the run-up to 2008.

In the same way, Islamic restrictions on debt would have prevented the asymmetries of a system where risk-taking rewards certain individuals while requiring taxpayers to cover any losses incurred.

SOUND PRINCIPLES

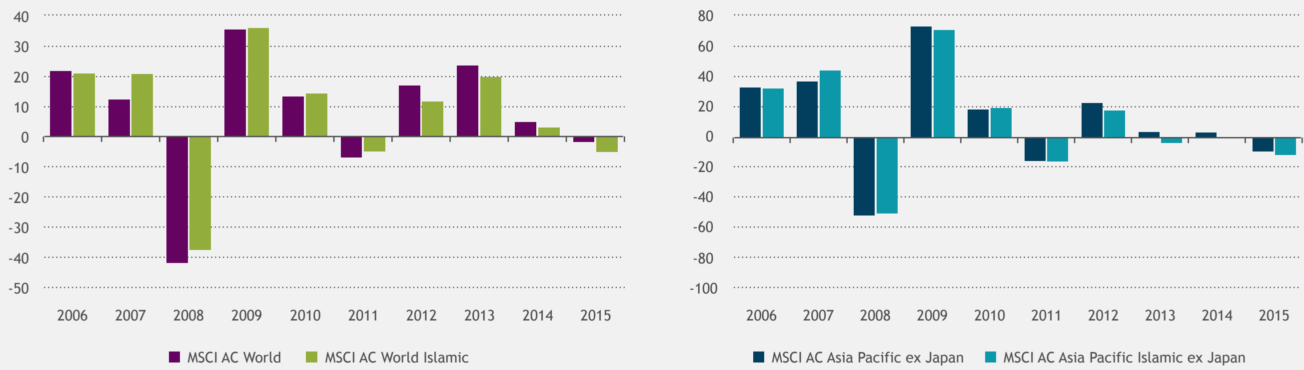
Another common misperception is that Sharia law dictates where investments can and should be made. In reality, Islam makes no distinction between the spiritual and the secular; Sharia law merely stipulates where investments cannot be made.

For example, in terms of investments, Sharia places particular emphasis on haram, or 'forbidden' industries. Haram extends to all products and services considered addictive, including alcohol and gambling. Accordingly, all income generated from the manufacturing and marketing of pork, prostitution or pornography, among other industries, is also forbidden.

Rather than simple moral prohibitions, the frame of reference of Islamic finance governs personal conduct including individual responsibility to society and the notion of serving the common good.

This social awareness is exemplified in the concept of gharar, which seeks to eliminate ambiguity and deceit in Sharia contracts, including fraudulent acts or other undesirable consequences. From a financial perspective,

1. ANNUAL PERFORMANCE OF CONVENTIONAL AND SHARIA-COMPLIANT FUNDS (%)



Source: Aberdeen Asset Management; Factset; MSCI; 29 February 2016

this means that investment cash flows must be tied to real assets.

The principle of gharar is similar to contemporary ideas behind socially responsible investment (SRI). Under the premise of SRI, investments are based not only on financial return but also on their contribution to the social good.

In recent years, SRI has become embedded in the investing of public institutions in the West, whether by means of SRI-specific, ESG (environmental, social, and governance) mandates, or otherwise.

However, the affinity between Sharia-compliant investment and SRI has not yet been noticed by mainstream investors. Nevertheless, their converging investment concerns and approaches could be incorporated more widely into awareness raising of the potential of Sharia-compliant investments.

DUE DILIGENCE COMES FIRST

The final misconception relating to Sharia-compliant investments, in which fund managers are said to lack the required expertise, is being addressed by Aberdeen Islamic Asset Management Sdn Bhd (AIAMSB).

AIAMSB was awarded its Islamic fund management licence in Malaysia in 2009 and is a wholly owned subsidiary of Aberdeen Asset Management Sdn Bhd (AAMSB), which itself is part of a global investment management group. AIAMSB manages funds on behalf of both retail and institutional clients.

Both companies have a common investment approach, grounded in careful due diligence that involves visiting prospects and talking to their senior management before any investment is made. The purpose of this is to forge a deep understanding of the strategy and operations of these entities.

There is a particularly strong emphasis on good governance, accounting and organisational transparency, in addition to ensuring investee boards respect the rights of their minority shareholders.

The objective of AIAMSB is to invest over the long term. To that end, it first looks at downside risks, such as what could go wrong, with the aim of buying only those companies that have strong balance sheets and cash flow.

Moreover, a group of external Sharia scholars is responsible for screening all AIAMSB investments. In fact, because of Aberdeen's fundamental and comprehensive approach, few adjustments are necessary to make conventional model portfolios Sharia-compliant.

EDUCATION MATTERS

Clearly, there are fewer investment options available for Sharia-compliant funds than there are for conventional funds. This results in certain sectors being under-represented, or indeed, as is the case with regard to banking, absent altogether.

However, AIAMSB believes that the purchase of multiple stocks alone does not make a portfolio diversified. Rather, it contends that risk can be mitigated by running a concentrated portfolio and having extensive knowledge of every single holding.

Promoting its expertise requires AIAMSB to focus on educating investors about the attractions of Sharia-compliant investments. However, financial literacy across Asia remains weak and the situation is made more challenging by the incentive structure which governs how funds are bought and sold.

Malaysia serves as a benchmark for a way forward in this regard. In recent years, the Malaysian government has taken steps to increase the amount that the Employees Provident Fund (EPF), as the State agency responsible primarily for the administration of private sector workers' pensions, can invest in Sharia-compliant investments.

Furthermore, the EPF announced that it will offer all members the option of a purely Sharia-compliant pension from 2017. This is set to increase its investments in Sharia-compliant stock, thereby providing a significant boost to the industry as a whole.

Indonesia is also now looking to improve take-up of Sharia-compliant products. In 2015, the country's financial services authority relaxed its rules to allow domestic-approved Sharia mutual funds to invest at least 51 per cent, and up to 100 per cent, of underlying assets overseas; conversely, conventional funds remain bound by a 15 per cent cap. This is significant because as long as this discrepancy between conventional and Islamic segments exists, Sharia-compliant funds will offer advantages in terms of diversification.

Sharia-compliant funds, far from representing a restricted choice in terms of performance, diversity and expertise, offer investors a sound and potentially profitable alternative.

GERALD AMBROSE
Chief Executive Officer

client.services.my@aberdeen-asset.com

ABERDEEN ISLAMIC ASSET MANAGEMENT SDN BHD

Suite 26.3, Level 26, Menara IMC
Letter Box 66
8 Jalan Sultan Ismail
50250 Kuala Lumpur
Malaysia

+60 3 2053-3800
www.aberdeen-asset.com.my

Cagamas
National Mortgage Corporation of Malaysia

GALVANISING ISLAMIC FINANCE THROUGH SUKUK

To replicate the success of the Islamic capital market in Malaysia on a global scale, Cagamas is using its strategic positioning to promote the benefits of increased sukuk issuance and further regulatory incentives.

Sukuk has been critical to the progress of Islamic finance

Cagamas forms a key part of the Islamic finance ecosystem in Malaysia and is strategically placed to engender the growth of its Islamic capital market

A THRIVING ISLAMIC FINANCE INDUSTRY

Islamic finance in Malaysia has made significant progress since its inception more than 30 years ago, and now constitutes a comprehensive and sophisticated market. Over the course of the past three decades, the country's financial regulators, including its central bank, Bank Negara Malaysia, and the body responsible for regulating and developing its capital markets, the Securities Commission Malaysia, have implemented a series of infrastructural reforms to boost the growth of the sector and shape an environment conducive to progress. These efforts have included the introduction of measures that are key to the rise to prominence of Malaysian Islamic finance, for example the application of tax incentives and the creation of a harmonious legal and regulatory framework.

Islamic finance in Malaysia has reached a level of development in which minimal regulatory incentives are required to provide further impetus to the sector. The market itself is providing a form of incentivisation by enabling industry players to capitalise on the opportunities available. This is primarily due to the presence of the wider business ecosystem as well as multiple market players, including asset managers, takaful companies and Islamic banks.

Furthermore, the presence of this ecosystem and the magnitude of the players involved have the potential to incentivise issuers to consider issuing sukuk, especially considering the fact that issuance provides more favourable yields that are lower compared to conventional bonds. This differs from new markets, such as Morocco, Nigeria, Oman and South Africa, where sukuk issuance requires paying a slightly higher yield than conventional bonds.

FOSTERING CAPITAL MARKET DEVELOPMENT

As Malaysia's national mortgage corporation, Cagamas is mandated to promote home ownership and provide liquidity to financial institutions in the country. The company forms a key part of the Islamic finance ecosystem in Malaysia and is strategically placed to engender the growth of its Islamic capital market. In fact, it is one of the largest sukuk issuers in Malaysia, having issued both unsecured sukuk and Islamic Residential Mortgage-Backed Securities (IRMBS) totalling MYR46,485 billion, as of December 2015 (see fig.1).

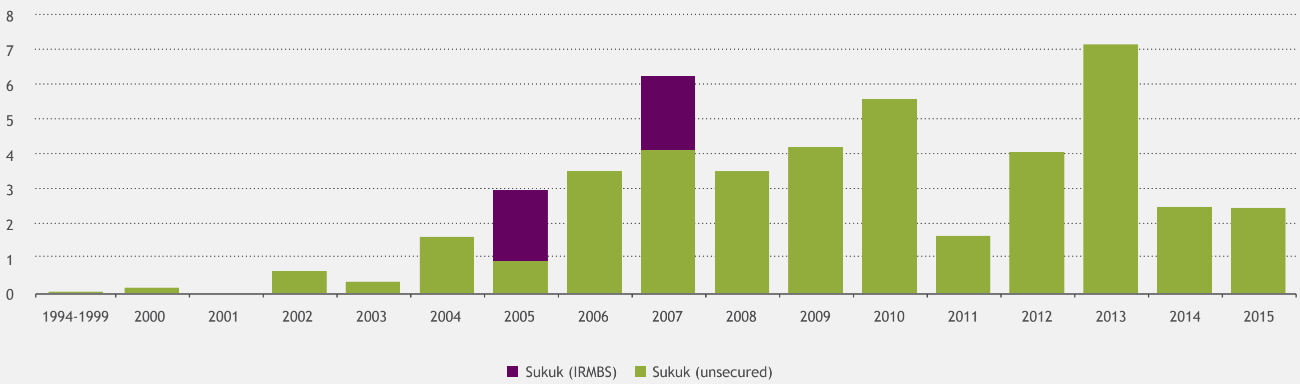
Since 1994, Cagamas has helped to stimulate the growth of the sukuk market by creating and establishing a pricing benchmark for the private debt securities segment. It has also taken the lead in terms of innovation, through the use of crude palm oil as an acceptable underlying asset to facilitate sukuk issuance. In addition, the pioneering efforts of Cagamas in the sukuk space have bolstered the confidence of other issuers, encouraging them to further develop their offerings.

From the perspective of Cagamas as an issuer, the type of sukuk used for issuance purposes depends on investor demand, among other factors. Fundamentally, Cagamas matches its issuances with the assets it purchases. Thus, the issuance of sukuk depends on the assets that Cagamas plans to acquire.

To achieve its objective of strengthening the Islamic capital market in Malaysia, Cagamas prioritises innovation and continuously seeks to introduce sukuk structures that are viewed favourably by investors. This is exemplified by the introduction of the company's first Islamic multicurrency medium-term note (MTN) initiative, the Islamic Euro MTN programme in 2014, valued at US$2.5 billion.

Additionally, the role of Cagamas in promoting home ownership is being facilitated by the development of affordable housing through linkage to the capital market, thus complementing the efforts of the main institutions financing these projects. To foster additional home ownership, Cagamas is exploring the possibility of utilising waqf land. Thus, the company is looking to help stimulate efforts to standardise rules regarding estate management by the distinct state religious councils, since such standardisation would facilitate the overall process.

1. CAGAMAS SUKUK ISSUANCES, 1994-2015 (MYR IN BILLIONS)



Source: Cagamas Berhad

BOLSTERING ISLAMIC FINANCE ABROAD

Cagamas is recognised internationally for its promotion of home ownership and the development of the Islamic capital market. As a result, it is frequently used as a point of reference by central banks from distinct countries interested in learning about its working model. The Cagamas model is well regarded by the World Bank as a successful secondary mortgage liquidity facility.

Cagamas' advice has been sought by external parties regarding Islamic finance solutions in the area of Sharia-compliant investment. Through its activities in the Islamic finance sphere, including the publication of the textbook, Islamic Financial System: Principles & Operations, Cagamas has sought to promote the Malaysia International Islamic Financial Centre's (MIFC) initiative of Malaysia as an international Islamic finance centre.

Consequently, there is significant potential for the establishment of Islamic financial services in a number of countries. Fulfilling this potential would enable additional Muslim communities and investors to access domestic-based Sharia-compliant products and services. In turn, the emergence of Islamic finance in these underserved markets would require the presence of adequate Sharia-compliant assets in order to facilitate sukuk issuances.

Despite the widespread lack of Islamic finance options in Muslim communities around the world, global Islamic banking assets continue to grow (see fig. 2) and governments are beginning to realise the importance of implementing Sharia-compliant alternatives to conventional finance.

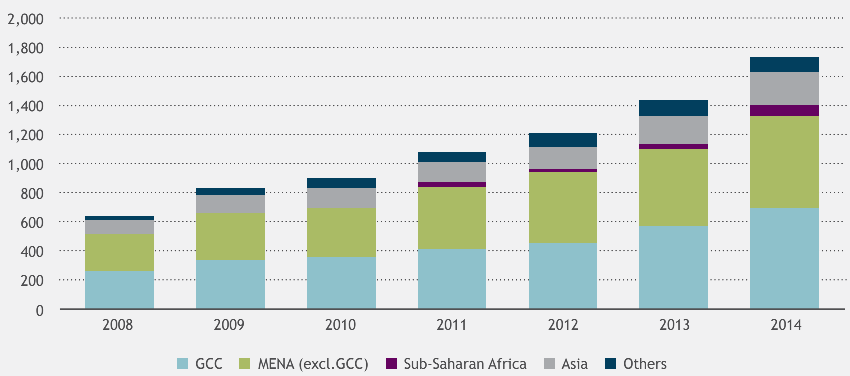
CHALLENGES AHEAD

Malaysia has an advanced Islamic finance sector as well as solid bond and sukuk markets. Nevertheless, its retail sukuk and bond space is relatively new and improvements therein will help the country contend with regional competitors, such as Thailand, which oversees a robust retail bond market. It is crucial that local regulators and market players address this matter to enhance the offerings available to individuals interested in sukuk investment.

At the international level, greater awareness and understanding of the needs of Muslim communities and investors is vital in order to foster greater access to and participation in the financial market. Increasing this participation could potentially help tackle the challenges of eliminating extreme poverty and expanding shared prosperity.

As a consequence, Cagamas envisions boosting Islamic finance education in countries that are neither financial centres nor have Muslim-majority populations. Efforts to increase knowledge of Islamic finance and the financial needs of Muslim communities will play a crucial role in the emergence of companies and institutions with a similar working model to Cagamas. With this scenario in place, all industry stakeholders will be better equipped to facilitate the consolidation and growth of the global Islamic capital market.

2. ISLAMIC BANKING ASSETS GROWTH TREND, 2008-2014 (US$ IN BILLIONS)



Source: Central Banks; IFSB; IFIS; Bloomberg; KFHR; and EY

CHUNG CHEE LEONG
President & Chief Executive Officer

info@cagamas.com.my

CAGAMAS BERHAD

Level 32, The Gardens North Tower
Mid Valley City
Lingkaran Syed Putra
59200 Kuala Lumpur
Malaysia

+60 3 2262-1800
www.cagamas.com.my

PERSPECTIVE: TOWARDS MORE ETHICAL FORMS OF FINANCE

The global banking crisis called into question the ethical standards of the financial sector, and prompted many investors to shift their attention to forms of finance that better align with their morals and beliefs. Two recent Islamic finance transactions illustrate just how such alignment can succeed.

Michael Bennett, Head of Derivatives and Structured Finance in the Capital Markets Department at the World Bank, reflects on the second Vaccine Sukuk issuance by the IFFIm

ISLAMIC FINANCE AND ESG INVESTING

News of malfeasance in the banking sector has been a fairly common occurrence since the 2008 Financial Crisis. Incidents ranging from structured product mis-selling, to LIBOR rigging, to allegations of money laundering for criminal organisations all raise troubling questions about the ethical standards of certain banks and bankers. Accordingly, the growing interest in more ethical forms of finance in recent years is not surprising.

Islamic finance and investment funds that follow environmental, social and governance (ESG) standards are two areas of ethical finance in which assets have increased at particularly sharp rates in recent years. Importantly, both areas involve investors using their money in a manner that conforms to their morals and beliefs, unlike conventional finance, which has traditionally been driven solely by efforts to maximise risk-adjusted returns.

Both Islamic finance and ESG investing have deep historical roots. The principles of Islamic finance are drawn from the Holy Quran, the Sunnah and centuries of scholarly interpretations of those sacred texts. Similarly, ESG investing can be traced back to religious writings, such as those of Anglican minister and theologian John Wesley. Nevertheless, these two forms of finance have only emerged as well-developed, globally relevant investment strategies in recent decades.

Investing in an ethical manner is not necessarily an altruistic activity in which returns must be sacrificed. In fact, investing in companies that engage in unethical behaviour often leads to poor returns, as illustrated by the sharp decline in the equity and bond prices of Volkswagen following its emissions scandal in September 2015; investors in BP Petroleum stock learned the same hard lesson at the time of the Gulf of Mexico oil spill in 2010. The securities of companies with poor environmental, social and labour records often make for under-performing investments in the medium to long term. Investing in an ethical manner, therefore, can be both consistent with the investor's beliefs and a highly effective investment strategy.

THE VACCINE SUKUKS

As the outstanding volumes of both Islamic and ESG investments continue to expand, the convergence of these two markets begins to appear increasingly inevitable. One recent pair of transactions that demonstrates how this convergence can occur is the two sukuks issued by the International Finance Facility for Immunisation (IFFIm).

IFFIm is an international organisation that accelerates the availability and predictability of finances for the immunisation of children, as well as the related strengthening of the local health services, in low-income countries around the world. These actions are carried out in collaboration with another international organisation called Gavi, the Vaccine Alliance. Gavi was created in 2000 to address the problem of stagnating, and even declining immunisation rates, in low-income countries. Since its creation, Gavi funding has been responsible for 500 million additional children being immunised; the mortality rate for children under five years of age has declined by 28 per cent over the same period.

Backed by financial support from nine sovereign governments, namely the UK, France, Italy, Norway, Australia, Spain, the Netherlands, Sweden and South Africa, IFFIm raises funds on the international capital markets, which are subsequently channelled to Gavi. The World Bank acts as Treasury Manager for IFFIm and handles all funding activities, under the direction of the IFFIm's volunteer Board of Directors.

IFFIm was established in 2006 and immediately began issuing bonds. It issued its first sukuk in December 2014, which was a three-year, US$500 million issuance, making it the largest debut sukuk ever by a supranational entity. It became known as the 'Vaccine Sukuk', since the proceeds were used primarily to finance the purchase of vaccines, and introduced the concept of ESG investing to the sukuk market.

Despite the philanthropic purpose of IFFIm, investing in the Vaccine Sukuks was not regarded as a simple act of charity by the investors. The sukuks were rated Aa1 by Moody's, primarily due to the strength of the financial support IFFIm receives from its nine sovereign donors, and the profit rate of the sukuks was consistent with such a well-rated obligation issued by a supranational entity. Moreover, the Vaccine Sukuks marked the first time that most sukuk investors had ever considered a transaction that provided both economic and social returns.

IFFIm's inaugural sukuk was warmly received by the market and won numerous awards, including the prizes for innovation in Islamic finance from Euromoney and achievement in transformational finance from the Financial Times. The success of the issue and the strength of the demand, which attracted more than

US$700 million in orders, led IFFIm and the World Bank to return to the sukuk market in September 2015. While the marketing of IFFIm's debut sukuk primarily involved introducing the ESG concept to sukuk investors for the first time, with the second Vaccine Sukuk the issuer also made a concerted effort to introduce the sukuk product to conventional ESG investors.

The second Vaccine Sukuk was joint lead managed by Standard Chartered Bank, who also acted as global co-ordinator, alongside Emirates NBD, Maybank, National Bank of Abu Dhabi and NCB Capital. In addition to this strong lead manager group, IFFIm brought in Morgan Stanley and Crédit Agricole, two international banks with a dedicated ESG focus, to act as co-lead managers and focus on attracting conventional ESG investors to the transaction.

The co-lead managers, in conjunction with the global coordinator, marketed the transactions to institutional investors in the UK and continental Europe with an ESG focus. This particular approach not only involved educating investors about the nature of sukuks, but also explaining the underlying transactions, which are required to ensure the structure is Sharia compliant.

The economics of the Vaccine Sukuk mirrored those of a floating rate note, and the name-recognition and life-saving mission of IFFIm were well known in the ESG market. Nevertheless, the structure of the sukuk itself was new to most of the investors. In particular, conventional investors needed to understand the use of a special purpose vehicle (SPV) issuer in the structure.

The structure used for the Vaccine Sukuks is called a 'commodity murabaha', and a separate SPV issuer was created for each transaction. The issuer issued the sukuk certificates and used the proceeds raised from the investors to enter into a series of commodity purchase and sale transactions with IFFIm. The payments from IFFIm to the SPV issuer in respect of these commodity transactions form the basis of the profit rate payments made by the SPV on the sukuk.

Many conventional investors equate an SPV-issued security with an asset-backed securitisation (ABS), and in some cases have restrictions on the purchase of ABS paper. While the structure of the Vaccine Sukuk shared certain similarities with an ABS, the credit risk borne by the investors belonged to IFFIm, the AA-rated obligor. A critical aspect in marketing the transaction was ensuring that conventional ESG investors clearly understood this element of the structure.

CONVERGENCE: A CONCEPT PROVEN

There are two critical developments that must occur in order for financial products to appeal to both Islamic investors and conventional ESG investors. First, Islamic investors must increase their awareness of securities that use proceeds in a clear and socially beneficial manner. Second, ESG investors must understand the nature of Islamic structures. These two developments will certainly take time to materialise and require substantial educational efforts from both issuers and intermediaries.

In the case of the Vaccine Sukuks, such efforts proved particularly advantageous for IFFIm. The second Vaccine Sukuk was a three-year, US$200 million issue that was 1.6 times oversubscribed. It achieved an impressively diverse order book, with 65 per cent being placed in the Middle East, 18 per cent in Asia and 17 per cent in Europe. As with the inaugural transaction, the order book included both investors who had purchased IFFIm securities in the past, as well as those who were participating in an IFFIm transaction for the first time.

In aggregate, the two Vaccine Sukuks raised US$700 million, on orders of well over US$1 billion, in less than one year. Such a high level of demand from both traditional sukuk investors and conventional investors, including those with an ESG focus, proves that the convergence of these two areas of ethical finance is a distinct possibility.

Investing in an ethical manner can be both consistent with the investor's beliefs and a highly effective investment strategy

➥ Although in Arabic 'sukuk' is a plural form of the word 'sakk', for the purpose of clearly identifying that two separate sukuk were issued by IFFIm, in this Perspective the plural term 'sukuks' is used. The findings and conclusions expressed herein are those of the author and do not necessarily reflect the views of the World Bank or its affiliated organisations.

RHB Islamic Bank

OPTIMISING WORKING CAPITAL VIA FINANCIAL SUPPLY CHAINS

The provision of accessible financing solutions is vital for the development of Malaysian SMEs. RHB Banking Group has introduced two innovative offerings to support the growth of this segment.

RHB is providing tailored, customer-focused solutions

FSC delivers convenience to customers by overseeing their entire supply chain, from invoicing to settlement

EVERY CENT COUNTS FOR SMES

Small and medium-sized enterprises (SMEs) in Malaysia represent a fundamental part of the national economy, as the largest contributor to GDP growth. The Malaysian Government, under its SME Master Plan 2012-2020, aims to support the competiveness and growth of this vital sector and increase the contribution of SMEs to the country's GDP, employment and exports.

In the context of the present highly volatile and competitive business environment, accessible, reliable financial solutions are critical to ensuring SME success. Challenges, such as difficulties in securing increasingly expensive financing from financial institutions, underscore the importance of these solutions.

OFFERING INNOVATIVE SOLUTIONS

In response to this crucial need and in support of the bank's continuous efforts to enhance the viability of SMEs, RHB Banking Group (RHB) has introduced two innovative products: the Financial Supply Chain (FSC) platform, and Flexible Trade Finance-i (FTF-i). These products are aimed at assisting SMEs to grow their businesses at a reasonable cost and provide a seamless experience for customers.

FINANCIAL SUPPLY CHAIN PLATFORM

FSC is an end-to-end trade process and information system that helps to improve cash flow and working capital for clients. It provides a more structured trading system for members across the supply chain and the product offering is targeted at delivering financing solutions to Malaysian SMEs that lack collateral to support their working capital needs. The provision of such a cost-efficient platform enables increased growth in the SME community and positively impacts the Malaysian economy as a whole.

At present, companies must contend with challenges relating to a disconnect between supply chains and financial service providers. FSC delivers convenience to customers by overseeing their entire supply chain, from invoicing to settlement. By leveraging information technology, the platform facilitates greater interaction between users and entities critical to their operations, including banks.

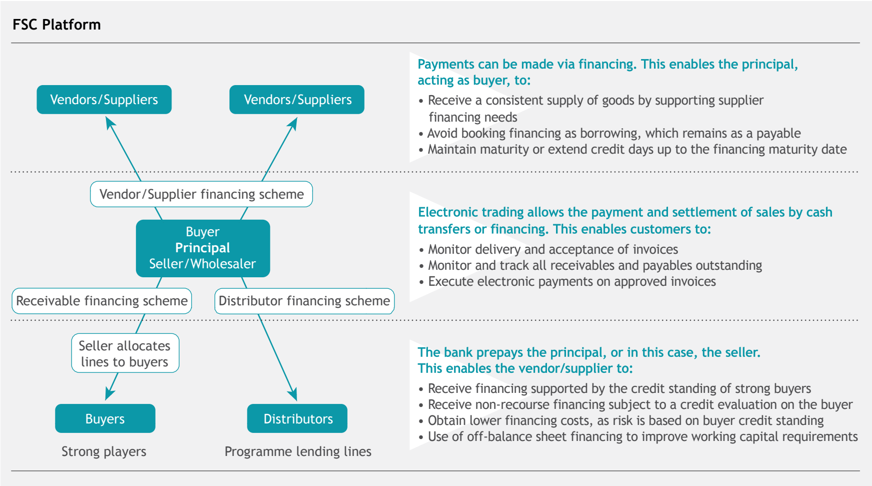
RHB understands the importance of meeting its customer requirements, and to this end, the platform functions as a financial community built around the needs of the principal client, enabling them to interact with suppliers, buyers and distributors in a closed trading ecosystem. Moreover, membership of this community enhances the capabilities of larger companies in assisting smaller organisations to access financing.

The web-based financial ecosystem solution runs on a secure platform and offers visibility for transactions made therein. In turn, this improves efficiency and helps to mitigate risks for members of the supply chain trading community. Significantly, FSC also facilitates billing and payment processes between members of the customer's supply chain community. In addition, transactions are made in real-time, thus further improving efficiency and allowing users to benefit from added savings.

Additional advantages of the innovative all-in-one financing platform include: its provision of an avenue for cash payment transfers and funding requirements via financing requests on outstanding approved invoices; and its delivery of cost savings for members who, for example, incur less charges by making business-to-business (B2B) cash transfers that the system considers as internal transfers. Importantly, FSC also treats financing as a prepayment of a trade settlement, rather than as borrowing. This form of off-balance-sheet financing, therefore, improves working capital management for platform users.

Furthermore, and in full realisation of the increasingly digital reality in which companies operate, FSC facilitates the management of invoicing and billing data, integrating invoicing maturity email alerts and immediate financing and invoice settlement into the platform.

Similarly, FSC offers increased operability, allowing users to interact with cash management and general ledger systems. In addition, it facilitates working capital management, risk mitigation and cash flow objectives with a full



spectrum of open account financing propositions, as well as streamlining the payment and reconciliation processes.

FLEXIBLE TRADE FINANCING-I PRODUCT

Among its portfolio of offerings, RHB has developed FTF-i, a new product that supports FSC by facilitating financing schemes for suppliers, distributors and receivables. This product is used to finance import and export businesses, goods, services, charges and payments, as well as any other local and foreign trade transactions that cannot be financed under the normal Islamic trade instruments.

The all-in-one product solution is administered under the Sharia principle of Commodity Murabaha, via the Tawarruq arrangement. This refers to the process of purchasing a commodity for a deferred price and selling it to a third party for a spot price in order to obtain cash.

FTF-i offers flexibility to customers by accommodating financing needs across a number of sectors, including transportation, ticketing and tour agencies, construction, logistics and other service-related industries.

The innovative product, moreover, provides support through all stages of a transaction, from pre-shipment to post-shipment financing, as well as for costs relating to the delivery of goods. In this respect, the offering takes a holistic approach to financing, providing coverage in terms of freight and transport charges, custom duties, port charges, takaful premiums and additional charges which may not be incorporated as part of the value bill.

STRATEGIC SUPPLY CHAIN SOLUTIONS

Customer satisfaction is a key priority at RHB, and in support of providing customers with a hassle-free and seamless experience, the FSC and FTF-i systems are designed to operate around a principal bank customer, allowing them to function as the buyer, seller or wholesaler. By means of this arrangement, RHB offers three types of supply chain management solutions: vendor/supplier financing; receivable financing; and distributor financing.

VENDOR/SUPPLIER FINANCING

The vendor/supplier financing solution enables the bank's customer to act as a principal buyer. This solution is focused on financing local and foreign vendor and supplier invoices that have been approved and accepted by the buyer. The buyer is able to connect with approved suppliers through the FSC platform and all financing requests can be managed online.

Benefits to the principal buyer include the possible extension to its payable credit term, improved liquidity of working capital, greater visibility relating to supply chain flows and a strengthened relationship with suppliers. The vendors or suppliers enjoy benefits including non-recourse financing, reductions in day sales outstanding, no collateral requirement and improved cash flow management.

RECEIVABLE FINANCING

The receivable financing solution facilitates financing for the customers of the bank's principal customer, who, in this instance, acts as the principal seller. This solution allows the bank to finance customers of the principal seller by purchasing the latter's receivables against invoice details that have been accepted and approved by the selected buyers. This can be undertaken with or without recourse to the principal seller.

Benefits to the principal seller include a reduction in day sales outstanding, improved cash flow management and visibility of the supply chain trade flow. The buyer, in turn, benefits from a possible extension to the payable credit term, improved liquidity of working capital and increased visibility of supply chain trade flows.

DISTRIBUTOR FINANCING

The distributor financing solution focuses on delivering bank financing to local buyers, such as distributors, dealers and agents on purchases made from the bank's customer, who, in this instance, acts as the principal wholesaler. All requests for financing are managed via FSC, which connects the wholesaler with its local customers.

Benefits to the principal wholesaler include a reduction of day sales outstanding, an improved cash flow position, increased sales and business growth and reduced buyer or distributor payment risk. The buyer benefits from a possible extension to the payable credit term, improved liquidity of working capital, greater visibility of supply chain trade flows and improved business growth with an additional sales limit.

AWARD-WINNING SOLUTIONS

RHB Islamic Bank is a leading innovator in the Islamic banking sector and remains committed to delivering innovative and cost-effective solutions to its customers. Its primary focus is to continuously enhance its range of products and services to meet ongoing market needs.

In recognition of its commitment to delivering flexible financing solutions to customers in the form of the FSC and FTF-i products, RHB Islamic Bank received the Most Outstanding Islamic Consumer Financing Products award at the Kuala Lumpur Islamic Finance Forum (KLIFF) in December 2015.

The provision of FSC technology, in conjunction with innovative financing solutions, enables RHB Islamic Bank customers to consolidate their standing in their respective industries. In fact, the platform represents RHB's commitment to its customers, as both a service provider and as a strategic financial partner, in their respective journeys of developing and expanding their businesses.

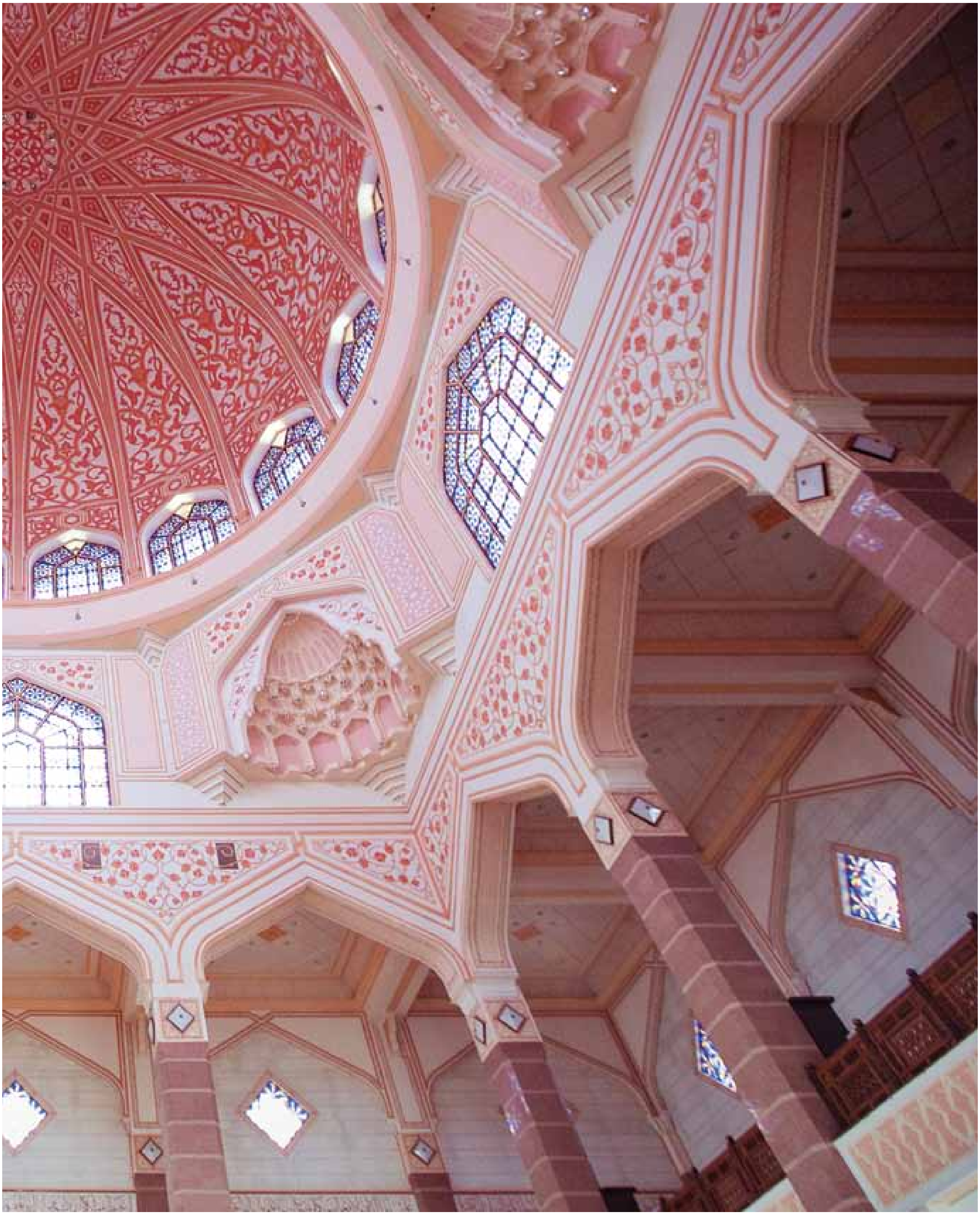
IBRAHIM HASSAN
Managing Director

ibrahim.hassan@rhbgroup.com

RHB ISLAMIC BANK

Level 11, Menara Yayasan Tun Razak
200 Jalan Bukit Bintang
55100 Kuala Lumpur
Malaysia

+60 3 2171-5000
www.rhbgroup.com



STRATEGIC REVIEW: HARNESSING THE POTENTIAL OF THE HALAL ECONOMY

A growing Muslim population and the rising demand for halal products and services will generate significant opportunities for halal economy market actors. However, in order to ensure the sector realises its true potential, industry stakeholders must address a variety of structural challenges.

AGENDA

- Context and definition of the halal economy
  - How extensive is the halal market?
    - Muslim demographics
  - The Islamic finance perspective
- SME access to finance and markets
  - Alternative sources of financing
    - The growth of crowdfunding
    - Boosting online presence
    - The role of venture capital and private equity
  - The response from the banking sector
  - Are Islamic and conventional SMEs treated equally?
    - Credit risk rating and bankability
  - How can bankers be helped to see SME market potential?
- Structural challenges in the halal economy
  - Supply-demand imbalance in halal food
  - Fostering international cooperation via sovereign wealth funds
- MNCs and SMEs in the halal economy
  - How can more SMEs become MNC suppliers?
- What is the key to restoring stability and sustainability in the halal economy?
  - Monetary policy and its structural problems
  - Bringing back the gold standard
- Stakeholder consolidation in the short term

PARTICIPANTS

RUSHDI SIDDIQUI
Chief Executive Officer
Zilzar

Rushdi is co-founder and CEO of Zilzar and Zilzar Life. He was ranked as one of the top 50 'Leaders of the Islamic Economy 2015' by publication Islamica 500, and is also a co-founder of Shekra, the world's first crowdfunding platform that conforms to the principles of Islamic finance. Rushdi has experience in the financial markets, having previously worked as Global Head of Islamic Finance & OIC Countries for Thomson Reuters, and Global Director of the Dow Jones Islamic Market Index.

SAFDAR KHAN
Group Country Manager, Indonesia, Malaysia and Brunei & Group Head, Islamic Payments, Southeast Asia
MasterCard

Safdar joined MasterCard in 2006 and has since held numerous key leadership positions across the company, including vice president, Global Account, South Asia, Middle East and Africa. His current role sees him driving the growth of MasterCard's innovative payments solutions locally and across the region. He has previously worked at ABN AMRO Bank and Citibank in distinct areas including financial services, technology and e-business. Safdar has an MBA from Virginia Tech, U.S.

HAFSAH HASHIM
Chief Executive Officer
SME Corporation Malaysia

Hafsah holds a degree in applied science from the Universiti Sains Malaysia and an MBA from Aston University, UK. She has extensive experience in public sector administration and has served in Malaysia's Ministry of International Trade and Industry, Ministry of Agriculture and the former Ministry of Primary Industries. Under Hafsah's leadership, SME Corporation Malaysia formulated the SME Masterplan 2012-2020 that will chart SME development to 2020.

SARIFFUDDIN MAHMUD
Halal Operations Manager
Nestlé Malaysia

Sariffuddin has 27 years of experience with Nestlé in Malaysia, having initially begun as a production supervisor and then manager at one of its cocoa processing plants in the country. He assumed his current post in 2010, sits on a number of industry committees relating to halal, and conducts best practice training on halal for Nestlé companies, suppliers and distinct Malaysian SMEs. Sariffuddin holds a degree in food science and nutrition from the National University of Malaysia (UKM).

ELAIN LOCKMAN
Director & Co-Founder
Ata Plus

Elain has over 20 years of experience in government-linked corporations and start-ups across a number of distinct sectors, including oil and gas, ICT and carbon management. She has worked at PETRONAS, the former Multimedia Development Corporation and Malaysia Debt Ventures, and is actively involved in the start-up community. Elain has a degree in actuarial science and a masters in operational research from the London School of Economics and Political Science.

AMRAN MOHAMAD
Chief Executive Officer
SBI Islamic Fund (Brunei)

Amran currently manages two Sharia-compliant private equity funds at SBI Islamic Fund (Brunei), which is jointly owned by the Ministry of Finance, Brunei, and the Japanese financial group, SBI Holdings. He has 20 years of experience in banking and fund management in Southeast Asia and was involved in setting up the Al-Rajhi Bank, Malaysia, serving as its founding board member. Amran holds an accounting degree from Edith Cowan University Western Australia.

PARTICIPANTS

KHALED MOHAMMED AL-ABOODI
Chief Executive Officer
Islamic Corporation for the Development of the Private Sector (ICD)

Khaled has over 25 years of experience, having started his career with the former Ministry of Finance and National Economy of Saudi Arabia as an economic researcher. He later served as director of the country's Environment Unit and as acting director of the International Financial Institutions Department. In 1995, Khaled moved to Washington, DC to serve as Alternate Executive Director for Saudi Arabia at the World Bank, before joining the Islamic Development Bank Group.

IBRAHIM HASSAN
Managing Director
RHB Islamic Bank

Ibrahim currently oversees the RHB Banking Group's overall Islamic banking business and operations, both locally and abroad. Prior to his appointment as Managing Director, he served as President Director at PT Bank Maybank Syariah Indonesia. Ibrahim has over three decades of experience in the conventional banking and Islamic banking businesses, having previously served in a leading local banking group, where he held a number of senior positions.

JAMIL BIDIN
Chief Executive Officer
Halal Industry Development Corporation (HDC)

Jamil has more than 30 years of experience in the corporate sector, having been appointed to the boards of several companies in a number of distinct industries, including financial services, aviation and aerospace, as well as an investment holding company. In his current role, he is working to help transform Malaysia's halal industry into a global halal hub. Prior to his role at HDC, he was the Corporate Advisor of KUB Malaysia Berhad. Jamil has an accounting degree and an MBA.

DR AHAMED KAMEEL MYDIN MEERA
Managing Director
Z Consulting Group

Ahamed holds a PhD in finance from the University of North Texas, and a masters in economics from the International Islamic University Malaysia. He specialises in distinct areas including Islamic finance, economics, monetary issues and payment systems. Ahamed has extensive experience in teaching, training, consultancy and research in these areas and has authored a number of books, including The Islamic Gold Dinar, The Theft of Nations and Real Money.

ROUNDTABLE PARTNERS

MasterCard

SME CORP MALAYSIA

Rushdi Siddiqui
Chief Executive Officer
Zilzar

Rushdi Siddiqui, Zilzar: I would like to welcome you all to the International Investor: Halal Economy Strategic Review. One of today's primary goals is to gain a broader perspective on what is happening in this space from a practitioner's point of view.

The phrase 'Islamic economy' was coined in 2013 by His Highness Sheikh Mohammed, Vice President and Prime Minister of the United Arab Emirates (UAE) and Ruler of Dubai, when he formerly initiated the process of transforming Dubai into the capital of this newly defined economic system. The initial challenge was to enshrine the concept and begin clearly articulating exactly what the Islamic economy concept means, as well as defining the participants and their responsibilities.

> *"The pre-eminent Muslim lifestyle silo is food and beverage, which has the potential to be a leading global growth market"*

In terms of my company, Zilzar, one approach we use to assess the Islamic economy is through the lens of the Muslim lifestyle space, which can be described as consisting of eight silos. The pre-eminent silo is food and beverage, which is currently worth approximately US$1 trillion per year. It has been estimated that, as a group, Muslims consume more food products than the entire population of China; thus, this sector has the potential to be a leading global growth market. The other silos are cosmetics; pharmaceuticals; media and recreation; travel; fashion; Islamic finance; and halal logistics. It should be noted that the first three spaces I highlighted require significant amounts of halal certification.

I think it would be a good place to start by hearing our participant's thoughts on current trends and practices in the halal space.

Khaled Mohammed Al-Aboodi, Islamic Corporation for the Development of the Private Sector (ICD): I wholeheartedly welcome this opportunity to sit down with sector leaders and discuss pressing issues. As you all know, the ICD is the private sector arm of the Islamic Development Bank (IDB). It began operating in 2000 with the mandate to support IDB member country development by stimulating and enabling the private sector. Our mandate is similar to other multilateral institutions, with the proviso that all of our operations must be Sharia-compliant.

A big challenge in this regard is that Sharia-compliant finance either does not exist or is still in its infancy in many member states. Thus, in terms of finance provision, we have to spend considerable time clarifying certain issues with clients who are less familiar with the concepts and structure behind Sharia-compliant finance, such as taxation or the asset acquisition process itself. This can lead to lost opportunities for external parties.

As a result, the ICD adopted a new channelling strategy about five years ago to establish at least one Sharia-compliant financial institution in each member state by 2020. This institution may be a bank; an ijara company; an investment fund; a small and medium-sized enterprise (SME) fund; or a private equity (PE) fund, for example. The aim is to secure a channel through which ICD finance can be extended to the private sector.

In most member states, the private sector is dominated by SMEs, particularly in Africa and Central Asia. Thus, it is particularly important that we redefine our methods for reaching this segment, as SMEs usually require smaller amounts than we tend to provide. Accordingly, we are now running a line of finance through domestic banks, which includes educating these institutions about Sharia compliance. Moreover, we have launched ijara companies, particularly in jurisdictions with little or no Islamic banking regulation, such as in Palestine and Central Asia, but also in Malaysia, in partnership with Pelaburan MARA; and we have established a number of investment funds to further develop and financially support SMEs.

Generally, our services are in great demand because partnering with the ICD can reduce risk and present new opportunities. For example, one particularly successful programme in Africa is geared towards assisting conventional banks, i.e. non-Sharia-compliant banks, to become Sharia-compliant, or aiding them to open an Islamic window. This is significant, as opening an Islamic window can cost between US$4 and US$5 million and, since such institutions are often only valued at US$6

or US$7 million, it is challenging for these banks to execute. The pertinent point is that ICD seeks the most cost effective approach for such clients, and the aim of this type of programme is to expedite bank lending to local SMEs.

Safdar Khan, MasterCard: The growing size of the halal economy offers numerous opportunities for different stakeholders across all sectors. A 2015 study compiled by U.S. think tank, the Pew Research Center, shows that the Muslim population is expected to grow to approximately 2.8 billion and account for almost 30 per cent of the global population by 2050. The Asia-Pacific region is also home to the majority of the world's Muslims; therefore, local stakeholders should take note of the potential of this market and be active participants.

"The growing size of the halal economy offers numerous opportunities for different stakeholders across all sectors"

Industry stakeholders who are able to adapt their products and services to cater to this expanding population will reap the rewards. In fact, regional and global opportunities afforded by this sector are even greater, since the halal economy is not restricted simply to Muslims. Sharia-compliant products and services frequently appeal to non-Muslim consumers with similar values and demands for ethical financing.

It is encouraging to note how Islamic finance has already garnered a significant share of the halal economy. According to the State of the Global Islamic Economy Report 2016, global Islamic financial assets will potentially rise to US$3.2 billion by 2020.

The growth of the Islamic economy is testament to the importance of Sharia-compliant finance, particularly to the payments industry. It is also relevant in terms of the Malaysian Government's Economic Transformation Programme that seeks to consolidate the country as the indisputable global hub for Islamic finance. Malaysia is well placed to meet this objective, with the aforementioned report placing the country first in three of its six sub-sector indicators, namely Islamic finance, halal food and halal travel. The findings of research such as this serves to illustrate the growing potential of the wider halal economy.

Hafsah Hashim, SME Corporation Malaysia (SME Corp): The halal economy is an incredibly broad concept in which the halal aspect covers every link in the supply chain; all products and services must be Sharia compliant, from primary production all the way through to the Islamic financing stage. With this in mind, the objective of SME Corp is to provide policy and business support to SMEs working right across the supply chain, to help them secure the critical mass they require to become competitive.

The starting point for many SMEs is primary production. In Malaysia, SMEs are subject to multiple regulations at the production stage, including quality standards and compliance certification requirements. For example, in order to be authorised as exporters, SMEs must adhere to certain packaging guidelines. This is important because export certification enables a business to access the international halal markets. As we have heard, the opportunities within these markets are considerable and growing.

Such compliance is often a challenge for smaller enterprises, which is why SME Corp is continually developing its support mechanisms and working to complement the efforts of other actors, including the Halal Industry Development Corporation (HDC). For instance, SME Corp assists smaller businesses in the food industry to adhere to the Hazard Analysis Critical Control Point and Good Manufacturing Practice food safety regulations. As with the production of packaging, this is crucial because expansion into international food markets can only be considered once these initial regulatory steps have been taken.

There is no one-size-fits-all strategy in terms of SME requirements; different businesses have different needs, and the challenge is particularly acute for enterprises wishing to have fully Sharia-compliant operations. The most recent data from the Department of Statistics Malaysia shows that SMEs account for approximately 97.3 per cent of all businesses in the country, so

Safdar Khan
Group Country Manager, Indonesia, Malaysia and Brunei; Group Head, Islamic Payments, Southeast Asia
MasterCard

Hafsah Hashim
Chief Executive Officer
SME Corporation Malaysia

supporting the expansion of this sector is critical. The growth potential is huge, and only a joined-up, multidimensional approach from all stakeholders will ensure that this potential is fulfilled.

RS, Zilzar: Ibrahim, could you provide us with some context in terms of the Islamic finance perspective in Malaysia and explain how RHB Islamic Bank operates in this space?

Ibrahim Hassan, RHB Islamic Bank: As Safdar mentioned, the Malaysian government has set the goal of transforming the country into a global Islamic finance hub by 2020. As a result, in 2013 it enacted the Islamic Financial Services Act, in conjunction with the Financial Services Act, to enable the domestic financial system to meet the new financing demands. This new regulatory framework provides a legal platform for the development of Islamic finance in Malaysia, and part of the overall goal is to boost the ratio of Islamic to conventional financing to 40 per cent of total banking assets by 2020. At present, the industry sits at approximately 25 per cent.

The presence of Islamic finance in the country dates back to the incorporation of Bank Islam Malaysia in 1983, and has flourished significantly since additional domestic banking groups were authorised to open Islamic windows in 1993. The industry supports both the halal and conventional sectors of the economy, and the marketplace business model includes standalone Islamic banks, such as Bank Islam Malaysia and Bank Muamalat, as well as Islamic windows in conventional banking groups.

At RHB Islamic Bank, we actively embrace the growth of the Islamic finance sector in Malaysia and will continue to expand our offerings of Sharia-compliant products and services; not only for our own business development, but also to help the country meet its Economic Transformation Programme goals.

RS, Zilzar: It is imperative that the Islamic finance sector continually adopts new approaches in response to the growing demand for halal products and services. Accordingly, what strategies are being employed at a local, regional and international level to tap this increasing demand?

IH, RHB Islamic Bank: Islamic finance institutions have been accused of replicating conventional banking and offering products and services very similar to corporate and retail banks, even in the sukuk space. More recently, however, the Malaysian Government and Bank Negara Malaysia, the country's central bank, have been encouraging the development of genuine Islamic banking that cannot be replicated in the conventional sector. This essentially means supporting customers by participating in equity and participating in their business. At RHB Islamic Bank, we have been assisting customers by creating finance options and providing business support. In fact, to facilitate this kind of equity participation has been quite a challenge, as most institutions actually started on the commercial side.

> *"There is no one-size-fits-all strategy in terms of SME requirements; different businesses have different needs"*

On the other side of the balance sheet, regarding deposits, as a result of the aforementioned directive, Islamic banks are offering mudaraba investment accounts to retail and business customers that will behave as investments, as opposed to the previous situation in which an investment was behaving like a deposit. Clearly, this contract involves an element of risk and this must be explained to the customer beforehand. Furthermore, and significantly, mudaraba contracts are no longer protected by insurance providers or PIDM, the government agency that protects depositors against the loss of their insured deposits.

By offering mudaraba contracts, the sector will be able to provide a fully Sharia-compliant product that genuinely reflects Islamic banking principles. The consumer response has been quite positive and strategies such as this will begin to attract increasing demand as the preference for genuine Islamic financing products and services continues to grow.

SK, MasterCard: Rising consumer demand, driven by a growing Muslim population and increasing Islamic expenditure, is critical to any strategy that targets

the halal market. Banks and financial institutions are responding by offering innovative Sharia-compliant payment products and services.

MasterCard's approach to tap this rising demand is through collaborations with financial institutions, such as Maybank, CIMB, RHB, HSBC and Bank Islam, to encourage adoption among more Malaysians.

Innovation and technology are also crucial to differentiate Islamic products and enhance their appeal, with consumer insights being necessary as a foundation to improve products and services. A key strategic initiative for the sector lies in banks leveraging technology to improve customer service and customer engagement.

Our research in Malaysia, Indonesia and Saudi Arabia suggests that Muslim consumers demand products that not only help them stay true to Islamic values, but are also competitive and deliver relevant benefits and rewards. Such propositions are able to drive consumers to move more transactions to Islamic banking and bring in new consumers.

We have also established a strong partnership with CrescentRating, the world's leading authority on halal travel, through the release of the MasterCard-CrescentRating Global Muslim Travel Index. This represents the most comprehensive research on the Muslim travel sector. Beyond assisting consumers to identify Muslim-friendly destinations, the data which lists the top countries in terms of Muslim travel is useful to the travel industry for analysing opportunities to better cater to the needs of this unique segment.

MasterCard's strategy goes beyond tracking market trends. As a technology company in the payments industry, we also actively monitor and upgrade different attributes of our existing products and services such as safety features, in order to allow businesses to adapt to changing market needs.

KMA, ICD: In terms of ICD strategies, as I mentioned, we have been establishing ijara companies in countries that lack an Islamic finance regulatory infrastructure as part of our efforts to expand Sharia-compliant financing provision throughout IDB member states. This is important, since Islamic approaches, such as ijara companies, are crucial to the halal economy because they are an effective way of reaching the private sector and far easier to establish than banks, for example.

We implemented our first leasing operations in Central Asia, before then turning to Palestine. There, we have established the Palestine Ijara Company, in partnership with the Palestine Investment Fund and the Palestine Islamic Bank, which offers Sharia-compliant financing to SMEs in different sectors across the Palestinian market. This enables us to lend considerable support to the local Palestinian economy, and indeed, the leasing route adopted by ICD is a particularly effective tool through which to provide genuine and tangible assistance to private sectors across IDB member states.

“Islamic approaches, such as ijara companies, are crucial to the halal economy because they are an effective way of reaching the private sector”

In addition to our programme providing SME support through domestic banks, in 2015, we designed another strategy to expedite the development of member states' microfinance industries. As modern microfinance is broadly conventional, this strategy involves identifying a Sharia-compliant platform through which funding opportunities can be enhanced, while simultaneously complementing pre-existing systems and infrastructure.

Elain Lockman, Ata Plus: Microfinance is a very interesting segment. About five years ago, Ata Plus devised a microfinance debt product similar to an Islamic version of Kiva. Kiva is a non-profit crowdfunding organisation that provides an online marketplace through which the crowd, i.e. the general public, is matched with low-income entrepreneurs in underdeveloped and developing countries to help them fulfil their financial requirements. It originated in the U.S. and is now one of the most successful conventional debt financing platforms in the world.

Average loans placed via Kiva are US$412 and average repayment rates are just over 98 per cent. Interest rates are difficult to quantify, due to the complex lending

Khaled Mohammed Al-Aboodi
Chief Executive Officer
Islamic Corporation for the Development of the Private Sector

Ibrahim Hassan
Managing Director
RHB Islamic Bank

procedure involved, but according to the last publically available data from Kiva, from 2010, they averaged about 35 per cent, which is quite high. Kiva itself does not collect interest payments from loan recipients and lenders do not make interest on their loans. Instead, it is the local microfinance institutions working with Kiva that charge the interest; the organisation itself relies on donations, grants and loans for funding.

Generally, the way in which Kiva collects funds and its method of partnering with local microfinance organisations is a highly effective working model. As a result, this influenced our approach in the development of the framework for the Ata Plus Equity Crowdfunding (ECF) Platform.

Outreach can be far more expansive if it is complemented by technology, and I would be interested to hear from Khaled about how ICD intends to expand into microfinance.

KMA, ICD: We are relatively new to this area and are still assessing which Islamic microfinance model to adopt, although we will certainly be dealing with institutions and non-governmental organisations (NGOs), rather than directly with individual recipients. Devising a Sharia-compliant model is difficult since the amounts involved are small and funds often have to be in cash, but we understand the challenge.

We are looking at utilising our contacts from the channelling strategy I mentioned in terms of microfinancing, but most of our partners currently lack microfinance programmes.

We realise the importance of identifying ways to reach out to the financially excluded, which is why we began conducting research in 2015 into how ICD can target this particular group, including potentially adapting conventional models. This is an ongoing process.

SK, MasterCard: Following Elain's point, technology can be leveraged to reach a wider group of people. It plays a vital role in the halal economy, acting as the backbone that drives innovation. For example, digital financial services can help businesses adapt to evolving market conditions and sustain growth while providing access to mainstream financial tools and services for the unbanked and underserved.

In the payments sector, the supportive role of technology powers the infrastructure that enables transactions to be made simply, efficiently and safely. In turn, it helps to facilitate the business processes of larger companies and SMEs, enabling them to expand their online reach. Our partnership with Zilzar is a case in point: we provide technological expertise to support secure and scalable payments capability with an infrastructure that is well-equipped to grow with the marketplace, in line with evolving consumer and business needs.

RS, Zilzar: Technology will certainly play a crucial role in driving the halal economy, and I can attest to the value of MasterCard's expertise in terms of supporting Zilzar's sustainable growth.

I would like to shift the debate towards alternative models of financing. The distinction between microfinance and microfunding, which is essentially small-scale peer-to-peer lending, is important here. Agency costs are similar, due to the need to conduct due diligence between the principal and the agent, and reach is also similar. However, microfinancing still establishes a creditor-debtor relationship, whether Islamic or non-Islamic. Microfunding, on the other hand, is more similar to a venture capital (VC) model, only on a very small scale.

Given the similarities between these two types of financing, should we start moving away from debt obligation models and towards VC-based models, that would naturally diminish the pressure to pay back on those funded?

KMA, ICD: Ultimately, the ICD will have to move in that direction, particularly due to the increasing attention on crowdfunding. In fact, we are researching how financing can be mobilised via crowds, and this is very important, since a VC model means there is less pressure on financial institutions to provide financing.

This form of financing will be particularly interesting on the SME side: expanding the microfinance model so it is applicable and relevant for the SME sector, and then helping financial institutions to take on a facilitator role. Regarding funding, there is a general reluctance to invest in the current climate, even in more developed

RHB Islamic Bank

OPTIMISING WORKING CAPITAL WITH RHB FINANCIAL SUPPLY CHAIN

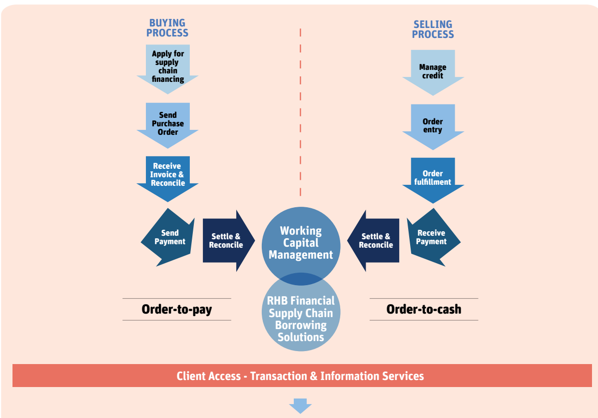
RHB Islamic Bank is committed to providing innovative solutions and has put in place the RHB Financial Supply Chain (FSC) platform to offer an easy-to-use and convenient system for parties in the supply chain ecosystem.

Many companies experience a disconnect between the supply chain and financial organisations but with advancements in information technology, RHB Islamic Bank customers can now easily interact with their counterparts, including banks, in the running of their business.

This platform is incorporated in our RHB Reflex Cash Management and is offered to our Reflex users as a value added service with no additional fees.

Managing Working Capital Efficiently

RHB Financial Supply Chain solutions manages the cash flow between parties in a supply chain, whether in the form of payment or short term financing. This assists in improving working capital management and liquidity generation, lowering costs and enhancing supply chain transparency.



RHB FINANCIAL SUPPLY CHAIN

Delivering More Convenience Always

RHB Financial Supply Chain oversees the customer's entire supply chain, from invoicing to settlement with the convenience of online access which features:

- A web-based financial ecosystem solution that runs on a secured platform which provides visibility of transactions done through the system. This will improve efficiency and risk mitigation to the supply chain trading members.
- Facilitates the billing and payment process between members within the customer's supply chain community.
- An avenue for funding requirement via structured financing program for outstanding invoices.

This innovative use of technology will help our customers reduce the cost of delivery and transacting with RHB Islamic Bank. Trading partners in the supply chain can trade within the system including transacting with RHB Islamic Bank without going to the bank.

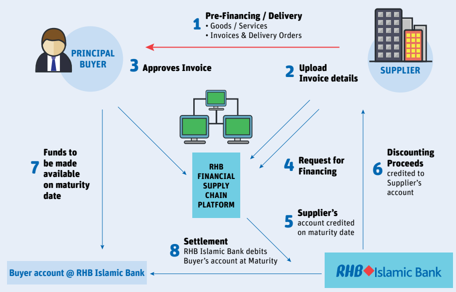
Your Strategic Partner in Supply Chain & Working Capital Management

Working capital is vital to corporate success and sustainability. We offer 3 types of working capital management solutions:

Vendor / Suppliers financing – focuses on RHB Islamic Bank financing the Principal Buyer's local or foreign supplier invoices that have been accepted and approved by the Buyer. The Buyer and all the approved suppliers will be connected via the RHB Financial Supply Chain platform and all financing requests will be done online.

Supplier Financing Workflow

This solution focuses on RHB Islamic Bank financing the Principal Buyer's local or Foreign Suppliers against Supplier invoices that have been accepted and approved by the Buyer.



Account Receivable financing – allows RHB Islamic Bank to finance its customers who are Sellers by purchasing the customer's receivables against invoice details that have been accepted and approved by the selected buyers. The financing can be done with and without recourse basis to the Seller.

Distributor financing – focuses on RHB Islamic Bank providing financing to local buyers (distributors, dealers, agents) for purchases from a wholesaler who is a RHB Islamic Bank customer.

The RHB Financial Supply Chain platform initiative will enhance RHB Islamic Bank's digital footprint in the business community and is in line with Bank Negara Malaysia's drive towards online banking transactions to achieve efficiency and lower cost of banking transactions.

For more information, visit any of our commercial business banking centres or call our customer call centre at 1300-888-742 or visit www.rhbgroup.com

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Elain Lockman
Director & Co-Founder
Ata Plus

VC spaces. Consequently, we must explore alternative mechanisms, like zakat or waqf. Many Muslims are looking for opportunities to fulfil their obligations, but they are reluctant to share across borders due to a lack of transparency. The demand is there; we just need a fatwa to enable us to proceed in this direction, in addition to a credible institution to execute these models.

EL, Ata Plus: Expanding the availability of alternative funding sources is crucial and the work we are doing at Ata Plus may be a useful example in this regard.

In June 2015, we were one of only six ECF platforms to be licensed by the Securities Commission Malaysia (SC), which regulates and develops national capital markets. The move by the SC into the crowdfunding space is particularly welcome, since it is becoming increasingly difficult for SMEs to access funding, especially from banks. The lack of access is largely due to issues such as turnaround time and certain other financial sector requirements.

"It is becoming increasingly difficult for SMEs to access funding, especially from banks"

Even though we cannot claim full Sharia compliance, due to the scope of the ECF guidelines, we have skewed our selection process in favour of Islamic-based products and services. The primary concern is that it must be halal. Furthermore, in order to further align with Islamic finance principles, we aim to work in conjunction with businesses that have an impact, be it on environment, ethics or communities. With socially responsible investment becoming increasingly mainstream, particularly in the West, this opens up additional opportunities for the company. In this regard, our goal is to position Ata Plus to tap the growing potential of the social impact investment market in Asia, which includes both Muslims and non-Muslims.

Eventually, we would like to see the emergence of debt crowdfunding because not everything can be funded through equity, there must be a balance. For example, equity funding makes little sense for SMEs requiring a small amount of capital. These companies do not want to relinquish stock for MYR250,000, for example, so debt financing would be more suitable in these cases.

We have already discussed these issues with SME Corp and plan to revisit the topic with Bank Negara, who is adopting a wait-and-see attitude regarding crowdfunding. Fundamentally, ECF can create tremendous value, not only for the SME community but also for the financial sector. A number of venture capitalists, PE funds and even banks have shown interest in potentially collaborating with us in this space. We have already held discussions with Standard Chartered Bank, Maybank and CIMB. Clearly, the banking sector is keen to keep up with the evolution of technology and its impact.

Innovation is the key to success. Although not Islamic, Alibaba's finance arm, Alipay, was a necessary step to service its trade and ensure sustainable growth. I think Islamic e-commerce platforms can follow suit because moves like this, in conjunction with work being undertaken in the ECF sector by the likes of Ata Plus, are crucial in enabling the Islamic finance community to stand on its own.

RS, Zilzar: Amran, how is SBI Islamic Fund Brunei tackling the challenges facing SMEs and access to funding, and what lessons can be learned from your work in Brunei?

Amran Mohamad, SBI Islamic Fund (Brunei): To provide some context, our fund is a 50:50 joint venture between Brunei Global Islamic Investments, which is the investment vehicle of the country's Ministry of Finance, and SBI Holdings, which is based in Japan. Nevertheless, most of our investment takes place outside Brunei.

In Brunei, the market has been anticipating the arrival of the ICD, which will be significant because SMEs are struggling to access finance there, particularly from banks. Thus, the ICD model facilitates access to finance for these SMEs through non-bank channels; I think it has the potential to be particularly positive.

In terms of SBI's investments, we frequently invest in late-stage SMEs, either bringing them to an initial public offering (IPO) or growing them in the region and selling them to large multi-national corporations. Our experience is that converting conventional financing to Sharia-compliant financing is a complicated process. For

example, we invested in a rapidly growing IT company in Singapore, but it was incredibly difficult to secure Sharia-compliant financing for the company because they were a service business with no assets to their name. Despite our best efforts with Islamic banks, we ended up jointly financing with HSBC, a conventional bank.

This was a setback for us because that particular company was non-Muslim and the shareholders took the necessary steps to convert the company into a halal entity, but we could not find the required financing to complete the job. Moreover, when we had to sell the company, we were unsuccessful in our search for a Muslim buyer and it was eventually sold to a conventional company. Nevertheless, we doubled the revenue during the period we were involved, which was positive.

This example illustrates the challenges in building a halal economy. Significantly, there is a need for market actors to continue to enhance the access and availability of Sharia-compliant finance, particularly for SMEs.

“There is a need for market actors to continue to enhance the access and availability of Sharia-compliant finance”

RS, Zilzar: Access to finance is undoubtedly crucial, as too is access to markets. Importantly, many smaller SMEs are offline, which essentially makes them invisible to the world. This situation stifles their ability to increase associated sales and impedes growth outside their physical footprint. That is why Zilzar has been in discussions with Ata Plus, as part of our efforts to help SMEs boost their export capability.

With this in mind, what are we, the industry players, doing to promote greater financial inclusion and assist SMEs to increase their online presence?

HH, SME Corp: Visibility and international market expansion are central to SME growth and an online presence can help to secure both. Thus, the early provision of technological assistance to SMEs is imperative, including the incorporation of information communications technology (ICT) into their internal management and operating systems.

Another critical factor here relates to SMEs obtaining critical mass, which can help a company become more competitive and reduce the cost of doing business. Market access is a key component in this process, which is why SME Corp is facilitating supply among Muslim-owned businesses by connecting them with relevant actors and markets all over the world. Of course, consumers can also be non-Muslim, and in fact, a combination of Muslim and non-Muslim markets will expedite this critical mass.

Returning to access to finance, SME Corp is promoting non-banking opportunities, and has numerous associated strategies coming on stream, such as the Malaysia Unlisted Market (MyULM). This initiative was created in conjunction with the SC and establishes a platform of unlisted market companies, commonly known as pre-initial public offering (pre-IPO), to facilitate access to capital and the transition to public listing. We evaluate the companies on the list and the most highly rated progress through the MyULM stream. To date, VC and PE investors have shown particular interest in using this platform as the basis for their investments.

Despite efforts to facilitate SME access to finance, many smaller companies are being left behind. In terms of microfinance, most venture capitalists are only interested in pre-IPO and mezzanine-level companies, and it is extremely difficult for small and microenterprises to access finance from banks, with interest rates often reaching as high as 34 per cent.

Having said that, figures from Bank Negara suggest that approval rates for SME loans were approximately 84 per cent in 2015. As such, we are targeting our response towards the remaining 16 per cent. Helping to bridge this gap is important because the potential of SMEs to contribute to the halal economy is enormous. Thus, facilitating their growth should be a priority.

IH, RHB Islamic Bank: At RHB Islamic Bank, we have diversified our portfolio and now offer corporate and retail banking services, in addition to business and SME services, and have established the goal of achieving 50 per cent retail coverage internally, whether conventional or Islamic. This step will provide invaluable banking assistance to SMEs in the halal sector and grant them a financial platform from which they can grow.

Amran Mohamad
Chief Executive Officer
SBI Islamic Fund (Brunei)


SK, MasterCard: Certainly, access to finance and online presence go hand-in-hand, and all stakeholders have an important role to play. First, in line with Hafsah's comment regarding ongoing support, it is vital that governments invest in SMEs to assist them in building their online presence. Second, businesses themselves need to be open to change, whether in developing new products and services for the online market, or employing the latest payment technologies to ensure safer and more secure transactions.

HH, SME Corp: It is certainly important that all parties, including governments and businesses themselves, do more in this respect, especially as the influence of the online environment grows. In fact, the consultancy group McKinsey stated in 2014 that big data analytics and online retail will have changed the entire business landscape by 2030. Therefore, it is vital that steps are taken to encourage the Muslim community to engage in not only the halal segment, but also the online business space in general, while making the most effective possible use of big data analytics.

SK, MasterCard: Facilitating the online presence of SMEs is particularly pertinent in driving the halal space due to the recent growth of e-commerce and the increasing global Muslim demand. I would like to share some statistics as proof points.

Business-to-consumer cross-border e-commerce around the world is estimated reach US$1 trillion in 2020, up from US$230 billion in 2014, according to Accenture and Alibaba Group's research arm, AliResearch. Within Malaysia, the domestic market, alongside Singapore, is the largest e-commerce market in the region. According to research from Euromonitor, the two nations generate approximately half of total online retail sales in the region. Consequently, the growth of this market and the resultant opportunities for halal e-commerce are evidently clear.

As previously mentioned, innovation will be key in successfully tapping this potential, and one area that continues to perform well, particularly in Malaysia, is mobile applications. MasterCard's Mobile Shopping Survey 2015 shows that the percentage of all shoppers in Malaysia purchasing via mobile devices rose from 25.4 per cent in 2012 to 45.6 per cent in 2014, and the country ranks third in mobile shopping growth in Asia-Pacific, behind Taiwan and India.

The rise in e-commerce and mobile applications represents a tremendous opportunity for all businesses, whether halal or non-halal. Online presence is important. It will not only help individual SMEs to grow, but also will provide opportunities for new business development and enhance cross-border spending, which can positively impact a country's economic growth.

RS, Zilzar: Mobile applications are intricately linked to the issue of youth; Zilzar research has found that, globally, there are approximately 500 million Muslims under the age of 30. Crucially, these 500 million young people are active on social media and mobile internet, inspired by their faith, have a rising per capita income and are largely middle class. While the majority of the world's two billion Muslims live on less than a dollar a day and represent the 'potential bankable', this demographic of young Muslims is the actual bankable. With the right strategy in place, industry players have the opportunity to genuinely excite potential investors, including those from the West.

In terms of SME access to finance, Ibrahim, are Islamic businesses receiving equal treatment compared to conventional enterprises?

IH, RHB Islamic Bank: The most important aspect in terms of credit evaluation is the ability of the borrower to pay back the loan, and we apply the same internal guidelines regardless of whether a particular business is Islamic or conventional.

We firmly believe in supporting the Islamic SME industry and work closely with distinct government agencies to that effect. Since 2012, for example, we have been collaborating with the finance provision entity, the Bumiputera Agenda Steering Unit (Teraju) by administering the Teras Fund, which aims to offer competitive financing rates and consultation to halal SMEs. Similarly, we entered into a Memorandum of Understanding with the Malaysian Technology Development Corporation in 2012 to oversee an additional Islamic fund to facilitate access to funding and advisory services to SMEs.

Part of our wider objective is to facilitate trade in the halal economy. With this in mind, we have established an internal digital platform, called a Financial Supply Chain, to support traders by enabling payments to be made between buyers, sellers and vendors at the click of a button. The platform has greatly improved the participating company's efficiencies, as well as their cash flow and working capital in terms of managing trade and transactions, resulting in cost and business management savings.

We also actively pursue musharaka deals, which relate to equity participation and profit- and loss-sharing initiatives. Accordingly, we collaborate with Bank Negara and a number of other Islamic banks in a related digital investment product called the Investment Account Platform (IAP). The IAP was officially launched in February 2016 as a centralised multi-bank platform that enables investors to place money into their accounts, from where they can directly finance ventures of their choice. Investors might be businesses or high-net-worth individuals.

SK, MasterCard: This leveraging of digital technology in the banking industry and business sectors is an important contributory factor that saw Malaysia ranked second, behind China, in the 2014 MasterCard Digital Evolution Index. This index lists the fastest moving digital economies.

Ibrahim mentioned Bank Negara's involvement in developing the IAP. Progress is being made in the area of digital investment products and this is reflected by the central bank's goal of increasing the number of e-payment transactions from 44 per capita to 200 per capita by 2020.

Nevertheless, more innovative Sharia-compliant payment offerings are needed to foster the growth of the e-payments landscape. This will not only ensure greater transaction convenience, safety and transparency in the e-commerce ecosystem, but also address the Islamic banking industry's needs to continue to grow and attract new consumers.

AM, SBI Islamic Fund (Brunei): The pursuit of equity or musharaka deals by Islamic banks in Malaysia is imperative. A lot of conventional banks are beginning to shy away from PE and Islamic banks from musharaka, due to the Basel III regulatory framework, which means that risk-weighted averages for institutions engaging in musharaka are far higher. In fact, many Islamic banks wishing to engage in PE are unable to do so due to restrictions that centre on Basel III.

To address this issue, the industry has highlighted two possible options: to come to an arrangement with authorities, whereby the percentage of the bank's assets used for musharaka will not be considered in the risk-weighted average; or to look beyond the bank's executive management and get the shareholders to do the VC or PE set-up.

Historically, SMEs in this region have lacked the financing platforms that are found in Western nations, such as the U.S., where start-ups can access series A and series B financing from PE investors or venture capitalists. Rather, in Malaysia there are a limited number of funds available for start-ups at the initial and latter stages of their development, but very little in between.

It is important that banks come together and devise ways to enhance funding opportunities for SMEs. They must foster access to series A, B and C financing to create a situation where SMEs can accurately prove their creditworthiness to banks, and then borrow or issue sukuk to move on to the next stage of development.

Ibrahim, will the Investment Account Platform you mentioned or similar initiatives help to deal with any of the issues I have outlined?

IH, RHB Islamic Bank: Essentially, the industry has been developing two types of investment accounts: the first is a general investment account, in which deposits are allocated to non-defined underlying projects or assets; the second is a profit-sharing investment account (PSIA), in which specific underlying assets are identified for that particular pool of funds.

In terms of the mudaraba and musharaka investments, as these types of investments are given a 150 per cent risk-weight, it requires the bank to hold a lot of regulatory capital. Thus, many Islamic banks are not prepared to participate in these kinds of deals because they are too expensive in terms of return on invested capital.

As a result, we have been encouraging the other banking groups with VC companies, which are not

subject to regulatory capital guidelines, to expand their offering of Islamic VC, using mudaraba and musharaka contracts, in order to support the underlying projects and, thus, economic development. Internally, RHB also has VC business and we are now developing the products to offer Sharia-compliant VC in order to support our investors and customers.

By promoting and facilitating mudaraba and musharaka products, the Malaysian Islamic banking sector is seeking to boost the prevalence of risk-sharing and equity-based contracts that are generally underutilised in the global Islamic finance system. We hope that others will be able to learn from this and follow suit.

KMA, ICD: I would posit that banks are often expected to do more than they can in terms of supporting SMEs. The issue here is bankability. To put it bluntly, if SMEs are bankable, the banks will finance them; if not, they won't. One solution to this would be encouraging non-banking financial institutions to support SMEs, which brings me back to ijara companies. Although these companies must ensure a stable cash flow, they have a lot more flexibility to support SMEs.

The simple fact is that unless governments relax constraints on banks relating to SME financing, progress in this segment will be limited. Although, at some point, the emergence of competition may drive banks to engage more with the SME sector and, in that case, I think musharaka will be most helpful.

Notably, however, the SME funds that we establish use a declining musharaka contract, which helps to address divestment issues. Even if you have doubled the size of the business over five years or so, it is still an SME, and because there is no small cap market in our member countries, divesting usually either means an owner buyout or finding another buyer. The declining musharaka means we can gradually decrease our involvement over time from 50 to 20 per cent, for example, making divestment much more feasible.

My second point relates to market access. It is increasingly common for member states of the Organisation of Islamic Cooperation (OIC) to establish export-import (EXIM) banks or export credit agencies (ECA) to strengthen their national export sectors. Most of these institutions prefer to deal with large corporations, rather than support SMEs. Moreover, the majority are conventional and so do not offer Islamic financing.

In response, we are devising programmes with some of our member states to encourage EXIM banks to support SME exports and establish Sharia-compliant modes of financing. However, further effort is required to encourage EXIMs and ECAs to engage with SMEs, and to do so in line with Sharia principles.

HH, SME Corp: Addressing the obsession with bankability is a critical part of overcoming the challenges facing SMEs. The conventional finance industry has prioritised the concept of bankability, which looks for proven track records, for example, when assessing SME credit applications and ignored additional factors that are equally important, such as being able to assess the potential of the start-up business based on a coherent understanding of the market reality.

> *“Many banks are not prepared to participate in mudaraba and musharaka investment deals”*

Adherence to these 'traditional' methods in Malaysia has resulted in the country losing numerous successful start-ups, including an award-winning light-emitting diode (LED) company to the U.S., the creator of the USB drive to Taiwan, and MyTeksi, or GrabTaxi, to Singapore. Start-ups in particular require access to finance in order to grow and it is important that banks learn to trust SMEs and are able to see their potential by understanding their business models and where an industry is moving in terms of the technology curve.

Consequently, we need to work with bankers to improve the 'non-banking approach' and behave like a PE and VC company. As I mentioned, the growing importance of big data analytics and online business driven by innovative, and predominantly small companies, such as those in e-commerce and social media, is completely changing the landscape. Therefore, it is important that stakeholders work, together with the banking industry, towards this new reality and facilitate start-ups, innovation and technology.

EL, Ata Plus: Developing talent in the banking industry to ensure decision-makers are able to understand the opportunities and needs of start-ups is fundamental.

Furthermore, I do not see active VC participation in the halal space; more must be done to address the financing gap between microfinance and PE, especially in Malaysia. Importantly, the reason why the VC model has been such a success in the U.S. is precisely because it was started by business owners, who naturally comprehend the requirements of start-up companies.

The founders of Ata Plus are seasoned entrepreneurs and so we understand the risks and challenges facing SME owners. To that end, we are working with the likes of SME Corp, HDC and Teraju to establish a more streamlined pre-screening process to facilitate the listing of businesses on our ECF platform. Ultimately, this is what businesses want: a swift, efficient process that enables them to simply focus on their business.

RS, Zilzar: In the U.S. peer-to-peer lending has become a huge market, as exemplified by the online loan marketplace, LendingTree. Interestingly, a large number of the loans available on LendingTree come from banks because they are seeing that these customers provide better returns than depositors. Something similar is happening in the UAE with Beehive and this mechanism will certainly find its way to Malaysia.

Ultimately, peer-to-peer lending will continue to take market share away from banks, as long as SMEs are unable to access the funding they require. The growth of this kind of financing is inevitable and I would urge all those around this table to promulgate that fact.

I would like to bring in Jamil Bidin, who has done fantastic work championing the halal space, to discuss the structural challenges at the heart of the halal economy debate.

Jamil Bidin, Halal Industry Development Corporation (HDC): The growth of the halal economy has been notable; nevertheless, obstacles remain and, given the rising number of Muslims around the world, it is clear that these obstacles do not relate to the market size. Rather, a huge issue hindering further expansion is confusion about the exact definition of the 'halal economy' or 'Islamic economy'. This has created a problem of awareness: some define the halal industry as just meat products or, slightly more broadly, as food products, but in reality the halal economy is a multi-faceted space that should include other economic aspects of Islam, including zakat, the waqf system and takaful. We must consider what role these concepts play in the halal economy.

The second factor that impedes the growth of the halal economy relates to the certain structural problems at the developmental level, as well as those concerning the industry itself. Such problems exist across every branch of the halal space, but two examples from the halal food industry are sufficient to illustrate the problem.

> *“A huge issue hindering further expansion is confusion about the exact definition of the 'halal economy'”*

The majority of halal food is produced in non-Muslim majority countries and certified by independent halal certification bodies that operate with little regulatory oversight. This causes problems of legitimacy and trust between consumers and suppliers. Furthermore, the global supply of halal food to the Muslim population meets less than 20 per cent of the overall demand. There are very few countries exporting halal food products, beyond Malaysia, Thailand and Australia, and these nations only export certain types of products, rather than the wide range of items required by consumers.

The ongoing supply-demand constraints have resulted in rising food insecurity across the Muslim world. This issue is particularly acute in the Middle East, which imports approximately 85 per cent of all its food and, unless steps are taken to rectify this situation, food insecurity will continue to increase.

RS, Zilzar: Structural issues are certainly inhibiting the growth of the halal food industry, as well as the wider halal economy. From HDC's perspective, what measures can be taken to address these problems?

JB, HDC: Overcoming these obstacles requires a collective and holistic effort; it cannot just be left

Jamil Bidin
Chief Executive Officer
Halal Industry Development Corporation

to industry actors and certainly requires top-down intervention from governments and, particularly, international institutions, which understand the intricacies of the halal economy.

For example, we have held discussions with the IDB about the halal economy as part of efforts to alleviate poverty in low-income OIC member states. We resolved to address the imbalance between financial and natural resources across OIC countries; some nations have substantial financial resources, but lack the arable land to produce the sufficient amount of food required to sustain a basic halal industry, and vice versa. During these discussions, we proposed establishing a fund led by the IDB to incorporate different sovereign wealth funds, such as Khazanah Nasional in Malaysia, from Muslim countries with strong financial sectors. The idea was to match their financial capabilities with the needs of other Muslim countries, such as Sudan, which lack financial resources, but have extensive natural resources. This type of matching would generate a form of social economy that could help Muslim countries regain, to some extent, control of their own food supply chain.

Despite our overtures to various institutions on this issue, nothing concrete has materialised. This is serious because the need for intervention is urgent.

RS, Zilzar: Given that approximately 80 per cent of the global halal food supply chain is controlled by non-Muslims, any effort to reconcile this issue would involve significant funding. An organic response, such as creating a Muslim version of Nestlé, for example, would be highly impractical in terms of pricing and competition. Alternatively, an inorganic approach via SME consolidation would raise problems regarding attracting investment, particularly from the Middle East, where investors are used to higher returns from established asset classes, such as real estate.

JB, HDC: That is true, and although institutions like the IDB do incredibly important work, more can be done to address the challenges facing the wider halal economy. For example, this issue of investors opting for more lucrative asset classes is significant. The proposed project I mentioned involving sovereign wealth funds and the IDB is, in fact, viable because sovereign wealth funds have social obligations, as well as financial ones.

Moreover, there are commercial opportunities within the supply chain, which tend to favour the PE and VC approach. Accordingly, we have been working to establish a halal investment fund based in Hong Kong and have already secured funding from five Chinese provinces, in addition to ten PE funds and venture capitalists from Hong Kong itself. The objective of this fund is to facilitate supply chain management in the region, as well as to help differentiate the developmental and commercial roles of governments, sovereign wealth funds and private actors in the field.

Additional steps required to boost the development of the halal economy are related to capacity building and the provision of real products. At the moment, this is not happening at the OIC level; trade between OIC member states is approximately 15 per cent of the overall total, whereas the figure is just 1 per cent in terms of trade in the food industry. This is far too low.

It is crucial that stakeholders also address the lack of convergence between halal and Islamic finance in Malaysia, which would help accelerate the overall growth of the halal economy. Figures from 2015 show that the utilisation of Islamic finance by the halal sector is less than 12 per cent, which is also too low. Since approximately 70 per cent of the halal players in Malaysia are non-Muslim, mostly from China, actors will simply continue to work with conventional banks if this lack of convergence continues. Despite our suggestions to the Department of Islamic Development Malaysia, which oversees halal certification, that this mode of financing should be mandatory for halal certification applicants, no such directive has been given.

Future growth of the halal economy also depends on shifting the focus beyond regular banking activities towards the incorporation of capital market instruments, like sukuk, that can broaden the market. To achieve this scenario in Malaysia, the regulator needs to be involved, and I posit that a dedicated regulatory authority on Islamic banking and finance is needed. However, what is required in the short term is a collective industry effort that focuses on awareness raising, promotion, capacity building, and financing initiatives to help decision makers understand the real potential of the halal economy.

KMA, ICD: The ICD has a US$600 million OIC-linked agricultural fund, which is advised by Rabobank. Two sovereign wealth funds are already participating in this initiative from Kuwait and Saudi Arabia, and they are viewing the opportunity precisely from the perspective of food security.

The aim of this mechanism is to provide investment across the entire food value chain of OIC member states and address some of the issues. For example, Sudan has a lot of potential, but there are serious logistical problems that add to the cost of food. Moreover, inefficiency is a significant challenge in many of our member states; Kazakhstan lost three million tonnes of wheat in one year because the country is unable to store it adequately.

I certainly agree that cooperation is needed and there is a lot to be done.

RS, Zilzar: Halal stakeholders need to revaluate in order to move forward. In fact, in order to consolidate the industry, the faith-based consumerism of halal needs to target private equity markets in the U.S. and Europe, where investors are looking for new asset classes.

Moving on to the relationship of large corporations and SMEs in the halal economy, Nestlé has done good work in raising the profile of the halal space. Sariffuddin, how does your established presence in the market help the company to tackle challenges such as the lack of SMEs in the halal chain?

Sariffuddin Mahmud, Nestlé Malaysia: Nestlé places tremendous importance on the halal space and so our approach is to concentrate on growing our business opportunities. To provide some historical context, Nestlé Malaysia adopted halal manufacturing practices in the early 1970s. When the voluntary halal certification process was introduced in Malaysia in 1994, Nestlé was the first multinational corporation (MNC) to request halal certification for its food products, and we have gone from strength to strength ever since. To date, 159 of Nestlé's 468 factories worldwide are halal certified and Nestlé Malaysia manufactures more than 300 halal food and beverage products that are exported to over 50 countries, making it the largest producer of halal products in the world.

Consequently, we are willing and able to share our sector experience and know-how with other industry actors. For example, we jointly organise and run an SME Mentoring Programme in collaboration with HDC and SME Corp. This programme enables us to disseminate Nestlé's best practices in production, sales and marketing, as well as halal-related matters affecting SMEs in the food and beverage industry. Approximately 300 SMEs have received this training and Nestlé itself benefits from the initiative in a number of ways. Primarily, it supports our ability to secure more locally produced raw materials for ingredient supply in Malaysia, since most of our ingredients are imported. Fostering the development of local suppliers can, therefore, help us realise this objective.

> *"The faith-based consumerism of halal needs to target private equity markets in the U.S. and Europe"*

However, this process is not always straightforward. As Hafsah has already mentioned regarding SME challenges relating to supply chains and compliance, any potential supplier of ours, or of any other MNC, must adhere to strict quality and safety standards, and must be financially sustainable.

Developing local suppliers is a challenge, but we have succeeded with a number of SMEs. Nevertheless, one of the pressing concerns in this respect is that, despite having good products, many of these SMEs have inadequate premises to become an international supplier of food ingredients and lack the financial capital needed to upgrade their facilities or move to another property. Furthermore, as Jamil has said, a misunderstanding and general lack of awareness about halal and the certification process is impeding the growth of SME suppliers in Malaysia.

Inadequate premises and a lack of knowledge about the halal process are precisely the reasons why Nestlé Malaysia is taking steps to educate small-scale suppliers. These kinds of efforts are incredibly important in ensuring the sustainability of Sharia-compliant SMEs and, in terms of the wider halal economy, Nestlé is

Sariffuddin Mahmud
Halal Operations Manager
Nestlé Malaysia

firmly committed to meeting the needs and responding to the growth opportunities of this sector.

"Lack of awareness about halal and the certification process is impeding the growth of SME suppliers in Malaysia"

HH, SME Corp: Small and, particularly, microenterprises have to comply with strict compliance regulations, including those set by MNCs, and they frequently lack the capacity to grow their business as a result. This makes the kind of support provided by Nestlé, as well as HDC and SME Corp, even more important.

To ensure a sustainable SME financing framework, it is critical that the narrow goal of securing returns on investment, whether by banks, PE or VC funds, is broadened to include a shared growth path for both parties. One of the main reasons behind our involvement in the SME Mentoring Programme mentioned by Sariffuddin is to help SMEs gain access to Nestlé's global supply chain; that is where the real potential is for small-scale supplier growth.

KMA, ICD: We are particularly interested in this topic because OIC countries are generally commodity producers, and the value added to their economies by commodities is low. We help member states, particularly in West Africa, to increase this value by assisting established and potential producers and suppliers. This added value creation creates economic benefits, not only for the supplier community, but also the wider national economy.

JB, HDC: A holistic approach that covers the entire value chain is the best way to provide space for SMEs to grow. Participation in Nestlé's SME Mentoring Programme is an important part of this. Stakeholders must ensure that more small suppliers are prepared to meet the global standards expected by Nestlé. In order for this to happen they must not only have access to finance and training, but there must also be intervention throughout the value chain.

The next step is to prepare these businesses to become an asset class and building the Islamic or halal economy brand.

AM, SBI Islamic Fund (Brunei): We have extensive experience in halal food resourcing distribution and retail in Indonesia. From what we have seen, a larger market actor is required to bring together the SMEs in a particular segment and oversee compliance with the kind of corporate governance required by large MNCs. However, the present lack of joined-up thinking is creating numerous wasted opportunities and eroding profit margins, particularly in the restaurant business.

I would like to see the ICD or IDB focus more on the ASEAN region, particularly given the growth of the online market in places like Indonesia and Malaysia. Without institutional support, there is a likelihood that non-Muslim MNCs will simply use their financial advantage to buy out the bigger online and offline businesses to the detriment of a fully halal supply chain. Thus, there is a need to foster the development of a large Muslim player to aggregate the smaller players and keep the supply chain halal. If an Islamic development institution was to provide a platform for funds and professionals to come together in order to build these types of entities and bring them to an IPO, that would be the most secure way to develop a halal asset class.

RS, Zilzar: There are a number of issues here. Privately held companies are often reluctant to sell anyway, but many SME owners have heard different horror stories about PE players opening leverage to finance dividend payments and are extremely weary; thus, we are paying for the sins of our predecessors.

To attract big players to this space, it is particularly important to consolidate the smaller players in the distribution sector. That is where the margins are and the track record is provable; it is a very lucrative business and is far more likely to pique the interest of the larger players.

Ahamed, as a consultancy firm that provides services to many of the sectors discussed today, including the halal economy, SMEs, VC and PE, what is your strategy for engaging the halal community in order to help the industry grow?

Dr Ahamed Kameel Mydin Meera, Z Consulting: We approach the halal economy from the perspective of growth and sustainability, with particular focus on money and payment systems.

As Ibrahim previously noted, Islamic banking in Malaysia was introduced in the early 1980s as a profit- and loss-sharing business, and over the years the industry began to focus more on debt-based instruments. This led to convergence with conventional banking because the two systems were operating in the same environment and bankers were profiting from the difference.

The solutions devised to resolve this convergence came in response to the 1997 Asian financial crisis, which itself was the result of structural problems relating to the monetary system. At the time, the former Malaysian Prime Minister, Mahathir Mohamad, raised the issue of nations settling their international trade balance in gold. This led academics, including those in the university at which I worked, to look at the effect this change would have on the sustainability and stability of the entire economic system.

I promoted the idea through academic papers for many years, but realised I needed to make concrete actions to push it forward. Thus, I left academia and teamed up with some ICT professionals to look for solutions that contribute to the growth and sustainability in the monetary system.

Importantly, we can only turn our attention to the Islamic system once the problems inherent to the conventional monetary system have been resolved. While micro-level projects in the halal economy are valid, ultimately, if the conventional financial system collapses it will take everything else with it.

Essentially, we can say that most of the money in the financial system is created out of nothing; it is simply information, upon which the banks charge interest. If you look at the statistics, they will show that debt is growing at an exponential level in almost every country; yet, the real economy grows more like a straight line, dotted with inflation and bubbles, including debt bubbles that ultimately burst. Thus, it is important to address these bubbles.

Since most of the money in the current financial system is debt, specifically, bank credit, we have been looking into an innovative financing system to secure the economic standing of SMEs, called the Commercial Credit Circuit (C3). C3 was developed by a Dutch research NGO, the Social Trade Organisation, and uses trade credit as money instead of bank credit, in which a promissory or electronic promissory note is used as 'money' that circulates electronically in the system until the final amount is paid. Essentially, C3 creates a lot of liquidity within the system and provides large amounts of cheap or free financing for SMEs. It also increases profitability and helps to raise taxes for government.

> *"A few parties have shown interest in replicating a Sharia-compliant C3 system, in the UK for example"*

Certain South American countries have implemented C3 on a conventional basis and we have been working on an Islamic version. A few parties have shown interest in replicating an Islamic C3 system, in the UK for example, and we hope that it can be rolled out across different economies within the Islamic space. Furthermore, we have an extremely solid working relationship with a network of Islamic scholars who are checking all Sharia-compliance issues as we move forward.

Importantly, there are essentially two kinds of money in the banking system: money as we know it and information. In crowdfunding, existing money is mobilised, whereas this particular system uses information as money. This approach reflects the teachings of Islam, in which money is recognised as one of two concepts: physical money or information. Consequently, using information as money means that liquidity can be increased, and, theoretically, the system could even be utilised to help solve the liquidity problems of struggling economies, such as Greece.

We will continue to develop a C3-based system at Z Consulting as, ultimately, it feeds back into our primary goal of promoting sustainable, halal-based financing and non-banking solutions.

RS, Zilzar: In terms of learning the lessons from the 2008 Financial Crisis and the 2011 European sovereign debt crisis, in addition to ongoing currency instability

Dr Ahamed Kameel Mydin Meera
Managing Director
Z Consulting Group

in Malaysia, what can be done to ensure that Islamic finance remains resilient and linked to the real economy?

AKMM, Z Consulting: For the sake of sustainability, money has to be linked to the real economy. The main problems relating to the current system began after the removal of the link between the U.S. dollar and gold in 1971. This has led to an overbearing financial system, which is not linked to the real economy.

The link between money and a real commodity, such as gold, has existed throughout most of human history, apart from the last 45 years, which is why numerous commentators are calling for a return to the 'gold standard', or whichever name you please, as a way of securing stability and sustainability.

In terms of Islamic finance, gold or silver as a standard traditionally formed a key part of Sharia financial principles. Of course, no linkage exists today, which is one of the reasons behind the increasing convergence of Islamic and conventional banking. In order for Islamic finance to be considered truly Islamic, as well as stable and sustainable, it is crucial that the link with gold is re-established.

JB, HDC: Our Hong Kong-based halal investment fund is experiencing some of the challenges mentioned by Ahamed. One of these relates to overcoming the widespread Chinese perception that Islamic finance instruments are synonymous with conventional ones. It is extremely important that the halal sector is able to explain Sharia financial principles to the Chinese because their interest in the industry is growing and Hong Kong has the potential to be a future centre of Islamic banking.

We are also concerned by the devaluation of the renminbi, which has led to issue relating to deciding the fund's denomination in order to cater for the five Chinese provinces that are investing.

AKMM, Z Consulting: By devaluing its currency, China is merely protecting its economy. Many countries have devalued their currencies to increase the competitiveness of their exports, which, in turn, creates employment, and the quantitative easing measures implemented by certain Western countries in recent years were undertaken with the same goal in mind.

Currency wars are widely documented and, theoretically, the way to stop these is to restore the link with the real economy. Significantly, there have been discussions among the BRICS nations (Brazil, Russia, India, China and South Africa) about restoring a link to the gold standard, in order to bring back stability. It will be very interesting to see how these discussions progress.

RS, Zilzar: To conclude our discussion, I want to focus on the road ahead. How can we stakeholders consolidate the halal sector in the short term to ensure its relevance and growth moving forward?

KMA, ICD: Islamic banking assets account for approximately 1 per cent of total global banking assets. This may not sound like much, but Islamic finance is a new phenomenon and the future looks bright.

Nevertheless, challenges remain and stakeholders need to facilitate the emergence of more industry promoters, such as multilateral institutions, governments and big corporations to establish clear frameworks and regulations, which other players will be able to implement and grow. To consolidate the halal economy, it is also imperative that stakeholders adopt best practices from countries such as Malaysia. The IDB will certainly play its part, and we plan to extend our reach in terms of crowdfunding, zakat and waqf.

AM, SBI Islamic Fund (Brunei): The importance of funds in order to foster the growth of both small and large halal players and the Islamic economy more generally is clear. The success of the Islamic fund implemented between the Brunei Government and SBI Holdings has shown that musharaka PE can secure good returns, while simultaneously promoting Islamic finance.

I think this has been a fantastic opportunity to understand the current state-of-play in the halal space, and I look forward to working with all of you in the future.

SK, MasterCard: Muslims view religion as a way of life, and so it is unsurprising that changing consumption patterns reflect their beliefs and they are increasingly asserting their religious sensitivities in the marketplace. This makes keeping up with consumer demands all the more crucial.

The value-driven belief behind the halal economy also makes the issue of trust and credibility extremely important; if Muslim consumers do not trust that the product or service they are consuming is halal, the Islamic space will lose credibility and growth will stall. That is why we are committed to working with financial partners in developing products and solutions that not only meet consumers' needs for Sharia compliance, but also are innovative, differentiated and secure.

HH, SME Corp: The key to consolidating the growth of the halal space is facilitating the emergence of critical mass among Muslim SMEs. This requires increasing the amount of institutional support to SME sectors around the world, particularly North Africa and the Middle East, in line with the Malaysian example of SME Corp.

Another factor hindering the expansion of the halal economy is the high rate of youth unemployment across the Muslim world. Estimates from the Arab Monetary Fund show that up to 28 per cent of Arab youth were out of work in 2015. It is, therefore, extremely important that halal stakeholders take active steps to engage the youth of today, while fostering the growth of communities of small Islamic business owners and suppliers. Only then will sustainable entrepreneurship be achieved within the Islamic ecosystem.

EL, Ata Plus: Our main strategy for consolidating the growth of the sector is to strengthen our support for Sharia-based SMEs looking to start out in the space. Primarily, we will continue to focus on facilitating access to finance for businesses through our crowdfunding platform. This is intended to provide greater liquidity to ensure the growth of SMEs. Without this access, businesses, and the halal economy, cannot grow.

This strategy involves overcoming a particular obstacle. In 2015, the SC established a fundraising limit for SMEs of MYR3 million in a 12-month period for every ECF fundraising round and MYR5 million in total on an ECF platform. This is relatively small in terms of SME requirements. Thus, we aim to work with development and financial service partners and selective partner banks, as well as venture capitalists and PE firms, to address the financial requirements of SMEs that need amounts in excess of MYR5 million.

JB, HDC: From our perspective, there are two key areas. First, the halal sector must focus on securing additional means of Islamic financing, including looking into the role of zakat and waqf. Second, HDC plans to collaborate further with a number of partners, particularly ICD, to share best practices, expand capacity building efforts and, ultimately, secure halal as an asset class.

Ultimately, international collaboration will not only help to ensure the growth of our respective companies or institutions, but it will also advance halal from being a niche sector to a fully sustainable and inclusive mainstream industry.

SM, Nestlé Malaysia: The main objective for Nestlé Malaysia is the continued growth of the halal economy and its constituent parts. We will continue to share our expertise and assist SMEs and entrepreneurs to become serious halal players, both locally and globally.

AKMM, Z Consulting: In terms of the sustainability of the halal economy, the mobile payment system will be the critical aspect in moving the industry forward. We have heard from Safdar about how MasterCard operates in this space, and it is increasingly important that industry stakeholders take steps to facilitate trade and transactions between the main actors involved: large companies, SMEs and consumers. Clearly, all such efforts must also ensure that any payment systems rolled out across the halal space are fully Sharia compliant.

RS, Zilzar: I would like to make two points in closing. First, Zilzar has 12,000 companies on our platform, but we do not know how many are Muslim owned. It has been highlighted that a significant proportion of the halal food supply chain is controlled by non-Muslims. Thus, we need to address the issue of Muslim inclusion in the halal space. Second, the concept of the halal asset class is very exciting and will really drive the sector forward. While there are still obstacles to overcome, we are certainly making progress.

Opportunities for dialogue, such as this Roundtable, are important and certainly contribute to the development of the industry; I hope we can reconvene to track our progress at some point in the near future. Thank you all for participating.

Tools such as the blockchain and crowdfunding are providing entrepreneurs with increased funding opportunities

FOCUS: REINVENTING THE ECONOMIC MODEL

The recent emergence of an economic structure that prioritises collectivism over individualism has prompted the development of more transparent business tools that now serve as the growth engine for this burgeoning ethical framework.

TOWARDS A MORE VIRTUOUS ECONOMIC MODEL

The current global economic climate has contributed to an increasing sense of uncertainty, in which oil prices have plummeted and world trade is experiencing particularly slow growth. In addition, the increasingly common occurrence of economic slowdowns and periods of boom and bust during the 20th century and into the 21st century have bolstered speculation about the sustainability of the present, widely adopted economic model.

As a result, international efforts are underway to reshape the traditional economic structure that centres on the primacy of private profit and ownership. These efforts are largely aimed at securing a system that supports inclusive economic and civic participation, unbound to potentially precarious financial institutions that defend the ideology of profit maximisation.

The rapid advancement of technology and widespread access to information from the internet serve as the foundation for this emerging economic structure that prioritises collectivism over individualism. During the wave of unemployment stemming from the 2008 Financial Crisis, entrepreneurs were able to leverage technology and social media to develop new means of satisfying the emerging on-demand economy. Companies including Uber, Airbnb and TaskPandas are just a few of the resultant start-ups that not only helped to create employment opportunities, but also to bolster economic efficiency by promoting the concept of a 'sharing economy', also known as collaborative consumption.

The sharing economy covers distinct notions and ideas and, as explained by a number of publications, including the 2015 article by academic Juho Hamari, Mimmi Sjöklint and Antti Ukkonen The Sharing Economy: Why People Participate in Collaborative Consumption, it is catalysed by technology and driven by a peer-to-peer, information-led society. This society engages in activities that include purchasing, offering, or sharing access to goods and services via online platforms. Such an economy yields collaborative consumption through actions such as renting, swapping and trading.

Similarly, and according to the author and journalist Paul Mason, collaborative production is becoming distinct from that of the traditional financial framework. This line of thought contends that goods and services produced under this new system no longer respond to traditional notions of market needs and managerial hierarchy. Rather, it holds that production caters to society's evolving requirements within a growing on-demand economy.

Participation in the sharing economy is deemed to be driven largely by the need to provide beneficial outcomes for others and for the environment, such as engaging in sustainable behaviour. This includes a shift towards more responsible means of doing business; a shift that reflects techniques traditionally used in the Islamic Gift Economy.

THE ISLAMIC GIFT AND SHARING ECONOMIES

The Islamic Gift Economy addresses the principle of voluntary exchange: the fundamental component of mainstream economics. It departs from classical economic theory that emphasises the maximisation of personal gain and interest and moves towards a more collective and common good. Ideally, in an Islamic Gift Economy, the focus is to ensure the circulation and redistribution of valuables within any given community, in contrast to the accumulation of wealth, thus minimising waste and inefficiency.

The Islamic Gift Economy is more than just a theoretical framework envisioned for a Muslim utopia. According to The Fundamental Problem of Exchange, a historical institutional analysis written in 2000 by the academic Avner Greif, the principles of the Islamic Gift Economy were practised by Maghribi traders during the 11th century by means of an uncoordinated multilateral reputation mechanism. Greif highlights that these trading communities adopted collective risk, relying on the shared supply of information and rules that were required for the coalition to function.

Most Maghribi traders were non-Muslims. However, they adopted the values of Muslim society and considered themselves to be members of the same umma, or community, which represented a society imbued with a universal responsibility and fundamental duty to practise good behaviour.

Within the Islamic Gift Economy, priority is placed on how transactions are carried out. This is usually via mutual and public consent in which both parties receive benefits in a transparent and ethical manner. In the absence of a formal enforcement mechanism, the approach of the Maghribi traders was to utilise information provided by religious institutions, as well as family networks, to successfully overcome transaction costs.

This process is similar to the example of the 21st century businesses that are leveraging technical and social technologies on an unprecedented level, all in the name of transparency, efficiency and social equality. Indeed, a sharing economy complements this ancient trading method because it is precisely this social convention, which is impacted by social media technology, that governs the exchange of goods. In turn, this ensures that collective public and private consumption is channelled towards both products and causes that benefit society.

This emerging sharing economy, which has been described as a 'social' or 'knowledgeable' economy, embraces a structural framework that enhances transparency and encourages risk sharing and redistribution of wealth for productive purposes. As is the case with the Islamic Gift Economy, the notion of a sharing economy envisions an integrated economic system based on cooperation, mutual consent and partnership. In turn, these principles are founded on the ethical precepts of mercy, gratitude, generosity, moderation, trusteeship and integrity.

A TECHNOLOGY-DEPENDENT ECONOMY

Participation in this new economic model is growing on a global scale. In 2013, Forbes estimated that the sharing economy was worth approximately US$3.5 billion, with growth exceeding 25 per cent from the previous year.

This impending shift away from the present socio-economic paradigm is said to be predicated on society's growing realisation of the need to develop a more equitable financial system built on collective interest and abundance. This is linked to a widespread belief that the fundamentals governing an economy built on self-interest and scarcity are not sustainable. In fact, this move away from a system that increasing numbers of people claim concentrates wealth, distorts incentives and is open to misuse by those in power could be interpreted as a change in consciousness.

As a result, conventional supply chains are gradually being disrupted by changes in consumer behavior. According to The Economist, global capital expenditure is beginning to shift away from manufactured and primary resources and towards higher value-added chains, such as software development and healthcare. Part of this changing dynamic includes people becoming more reliant on technologically intensive services and solutions, not just to reduce costs, but also to support local industries and communities.

Conventional supply chains are gradually being disrupted by changes in consumer behavior

One example of how technological advancement is being utilised to foster the growth of the sharing economy is the emergence of blockchain technology. A blockchain is a data structure that modifies the technical component of a transaction, making it possible to create a digital ledger of transactions and to share this among a distributed network of companies. This technology enables the usage of and reliance on an alternative currency through a widely accessible and open source platform. Bitcoin, the foremost of all cryptocurrencies, is built on blockchain databases and is used for a wide range of applications, from moving money across borders securely to supporting microfinance through a profit sharing model.

The underlying principle of blockchain is its focus on transparency, particularly relating to the reliability of value that backs the currency as a credible mode of exchange. The blockchain can be seen as a software design approach that binds a number of peer computers together that commonly obey the same 'consensus' process for releasing or recording information they hold, where all related interactions are verified by cryptography, according to William Mougayar, author of the article Understanding the Blockchain.

Another important aspect of the blockchain is the flexibility it provides in designing incentives for beneficial and productive social purposes by offering a highly divisible financial return. This yields a genuine and proportionate value for labour derived from an extensive model of financial inclusion.

Technological innovations such as the blockchain are highly scalable and disruptive due to the advent of the internet and the 'internet of things', which bolsters business opportunities by connecting objects and data. Their growing prominence can affect the way people live their lives and interact with their peers. However, it is important to note that technology, in this instance, serves as the means, rather than the catalyst.

Nevertheless, ideology and technology can work together in a virtuous circle. As societies become increasingly interconnected, values and expectations at both the individual and societal level are transforming. This is exemplified in a 2012 report from the consultancy firm McKinsey Global Institute, which found that approximately one-fifth of the world's population is connected to a social network of some sort.

Adherents of the sharing economy posit that this technology-driven interconnectedness has the potential to, eventually, facilitate the realisation of ideals such as universal access to education; mainstream environmental consciousness; accelerated growth of the organic and fair trade foods industries; increased impact investing as a sector; and greater innovation of biosensor-enabled mobile healthcare solutions. These ambitious concepts represent the demands of an increasingly connected and receptive 'crowd', that places people at the heart of the economic system.

CROWDFUNDING

In recent years, online platforms have come to serve as a gateway for individuals to band together to form empowered communities that support specific causes and help fund entrepreneurial projects that cater to society's needs. This concept is known as crowdfunding.

Crowdfunding campaigns are geared towards the ethical, transparent funding of businesses and social projects. The use of the funds frequently aligns with the collective knowledge of the crowd and is undertaken with the aim of allocating wealth and capital towards productive economic activities.

The crowdfunding space facilitates open and transparent interaction

Significantly, crowdfunding has experienced widespread growth in recent years. In fact, in its 2015 Crowdfunding Industry Report, Massolution, a research, advisory and implementation firm that specialises in crowdsourcing solutions, stated that it expects the crowdfunding industry to surpass total funding from venture capital in 2016. The same report documents that in 2010, the crowdfunding market accounted for just US$880 million, compared to US$34 billion in 2015.

Crowdfunding campaigns take many forms that range from non-monetary rewards in exchange for funding, to a more business-centric, equity-based campaign that offers shares based on total funding received. Similar to the idea behind the Islamic Gift Economy, the crowdfunding model aims to circulate wealth among the community, and this process is sanctioned via social technologies. In this context, the crowd embodies the market's 'invisible hand' by leveraging the power of social capital and interconnectedness to deliver goods and services.

Essentially, the crowdfunding space facilitates the open and transparent interaction between the main parties involved, including the operator, such as an online crowdfunding website, the investor, and the investee or company, i.e. the recipient of the funding. All three have certain duties to which they must adhere, and compliance with these responsibilities enables them to work together in support of a specific business opportunity or social good.

Accordingly, the main role and duty of the operator is to provide a trustworthy, transparent and fully monitored platform through which funding can take place. They must also ensure the presence of sufficient information to allow investors to make reasonable decisions about any given funding opportunity. In addition, the operator must work closely with companies to enable them to perform to their full potential across the platform, while continuously ensuring that priority is given to companies with a value-based approach.

The duties of the investor extend beyond simply securing a high rate of return. It is important that they form collaborative partnerships with the investee or company to assist them in the process of becoming more sustainable and, in turn, more capable of responding to ongoing social concerns.

In terms of the final party involved, the investee or company commits to full disclosure before the community, and places particular emphasis on the continued raising of business standards.

THE VALUE OF BUSINESS ETHICS

Crowdfunding has the potential to create a number of positive impacts for both society and the economy. First, crowdfunding is catalysing an increase in entrepreneurship, which will be conducive to combating stagnant economic growth by creating jobs and inspiring innovation, particularly among younger generations. Second, as economies become more responsive, businesses are likely to benefit and the increased presence of technological, online platforms will contribute to the emergence of a dynamic and highly skilled workforce. Third, productivity is expected to rise as knowledge workers market their services across multiple platforms while utilising distinct reward mechanisms to attract funding.

The rise to prominence of the sharing economy means that both the market and society may begin to reward ethical investors and companies in the short to medium term, not only financially but also socially. In addition, as the role of the State continues to be redefined, closer collaboration between the public and private sectors is anticipated in terms of addressing the structural issues present in the wider economic system.

Securing funding is a constant concern for all start-ups and early stage companies. In an increasingly competitive marketplace, the growth of the sharing economy shows that an important differentiator is no longer necessarily related to a product's price or purpose, but rather, how the company in question operates in terms of its business ethics.

Furthermore, tools such as the blockchain and crowdfunding are providing entrepreneurs with increased funding opportunities. Crucially, these tools also supply them with an alternative platform on which to develop a dependable, long-term business model, which is particularly important in an age of radical transparency. If a company is able to distribute social, ethical and environmental competency across its entire business operations, it will thrive in an evolving market ecosystem that, in line with the Islamic Gift Economy, places overriding value precisely on concepts relating to the social good.

➥ This feature was produced in conjunction with Ata Plus.

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