

Basic Principles and Global Trends in Islamic Finance

Prof. Dr. Volker Nienhaus



Presentation at the
1st IIR Islamic Finance and Real Estate Forum

Frankfurt
4-5 November 2008

Basic Principles and Global Trends in Islamic Finance

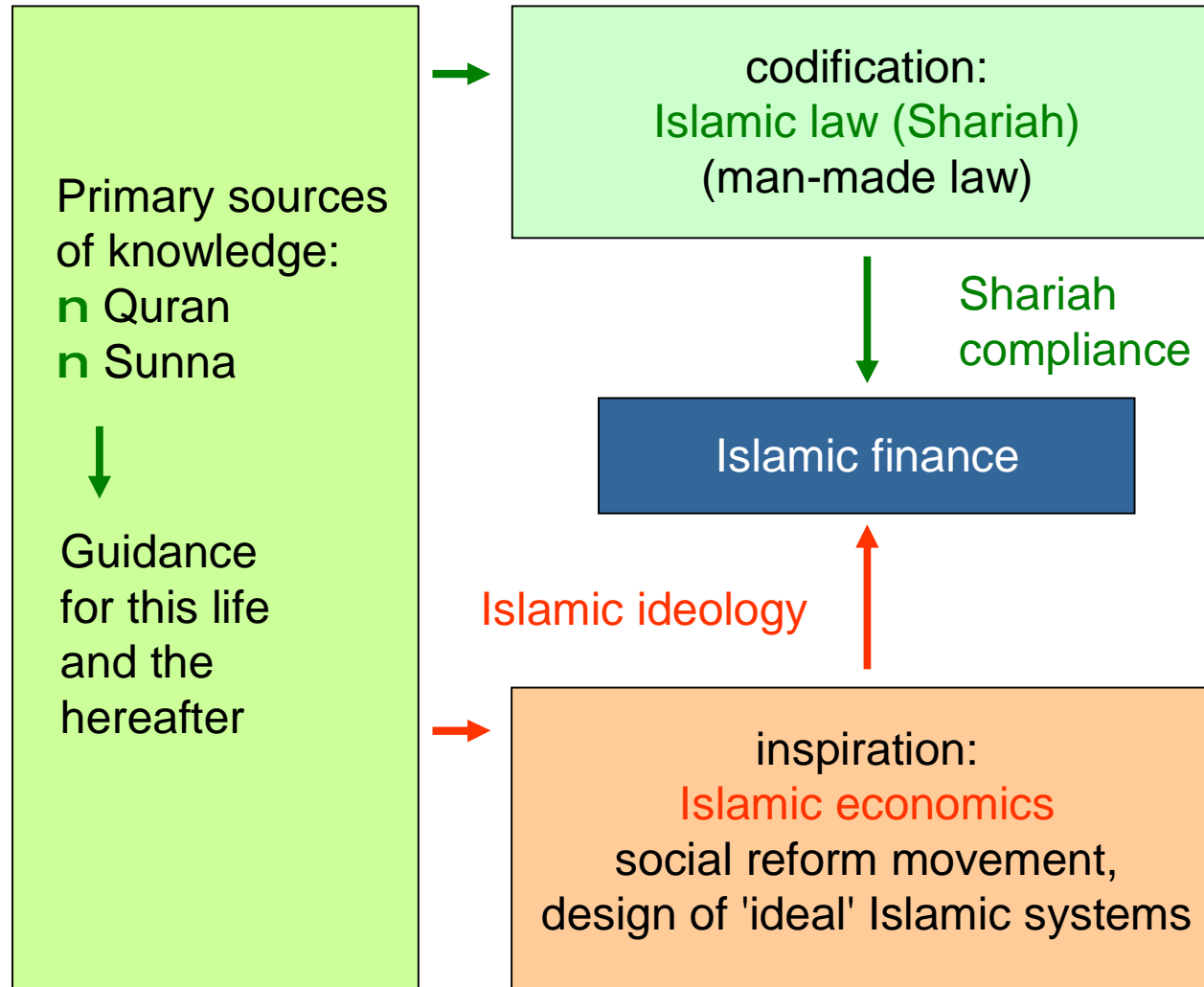
1. Islamic Finance between Islamic Law and Islamic Economics
2. Shariah Boards and Shariah Compliance of Contracts and Techniques
3. Structure, Volume and Growth of Islamic Finance (Banking, Capital Markets, Insurance)
4. The Infrastructure of Islamic Finance (Laws, Regulation and Supervision, Standard Setting, Training and Education, Consultancy, Rating, Media)

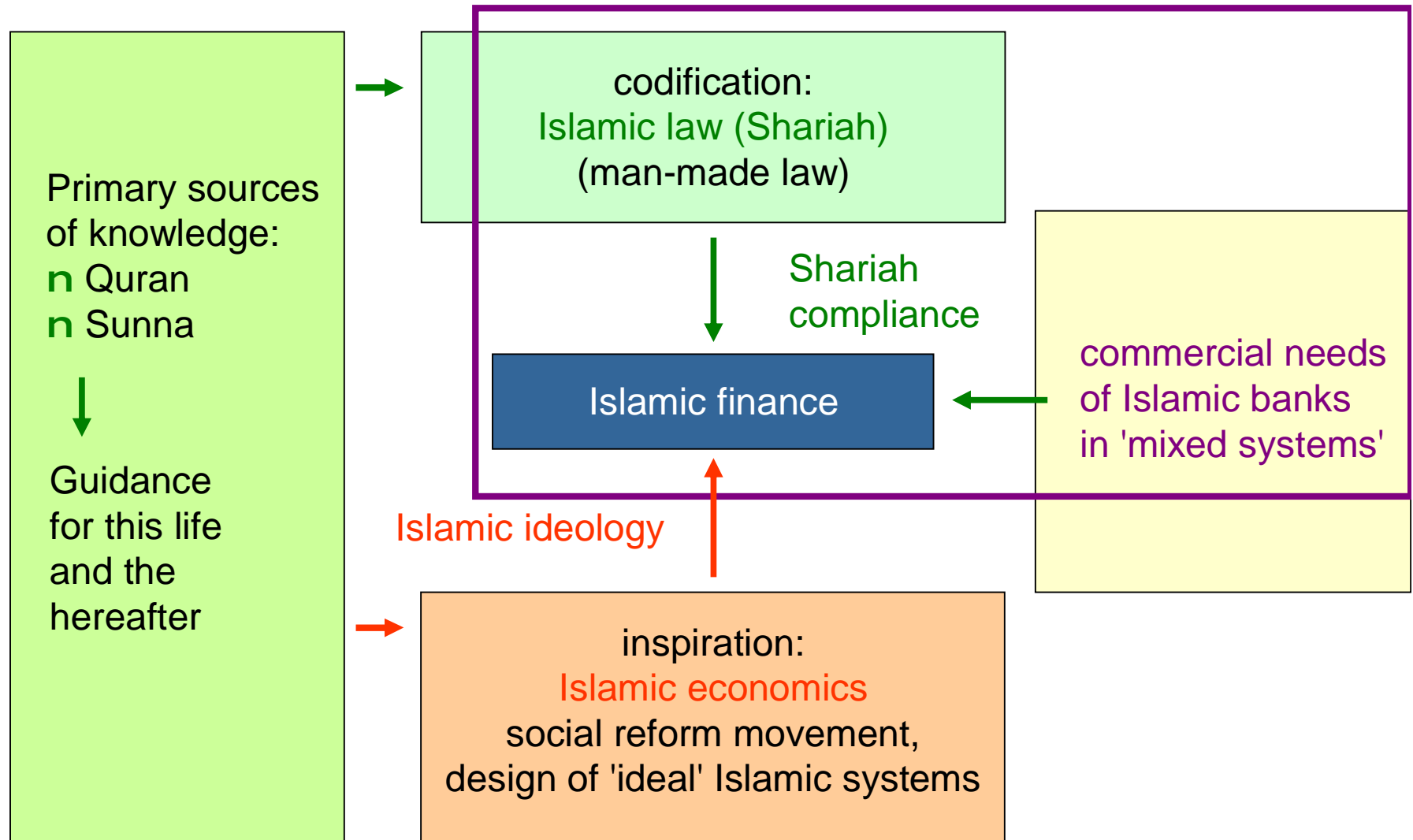
Primary sources
of knowledge:

- n Quran
- n Sunna



Guidance
for this life
and the
hereafter





Shariah governance: constitutive for Islamic financial institutions (IFIs)

institution

(individual)
Shariah
advisor

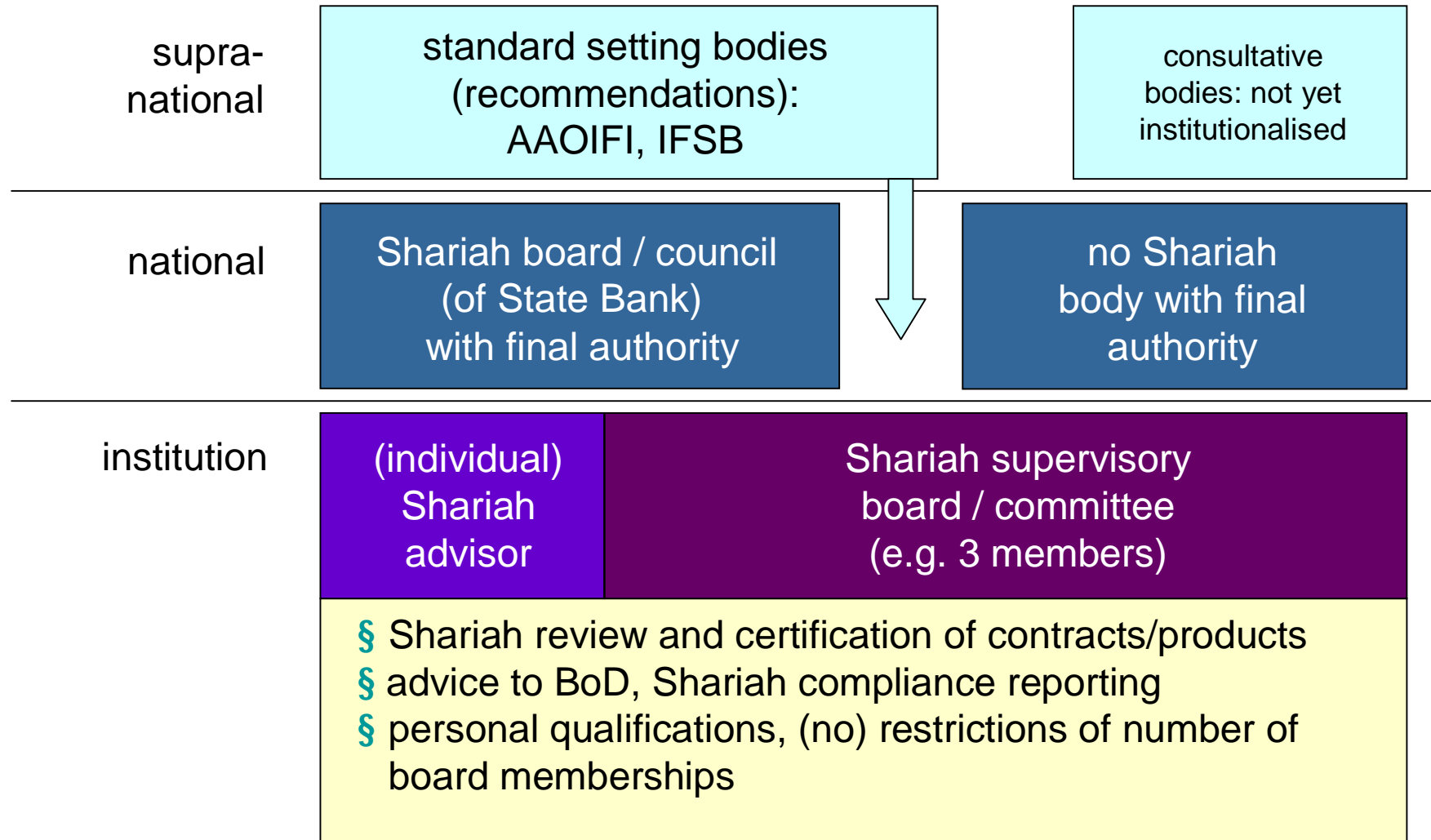
Shariah supervisory
board / committee
(e.g. 3 members)

- § Shariah review and certification of contracts/products
- § advice to BoD, Shariah compliance reporting
- § personal qualifications, (no) restrictions of number of board memberships

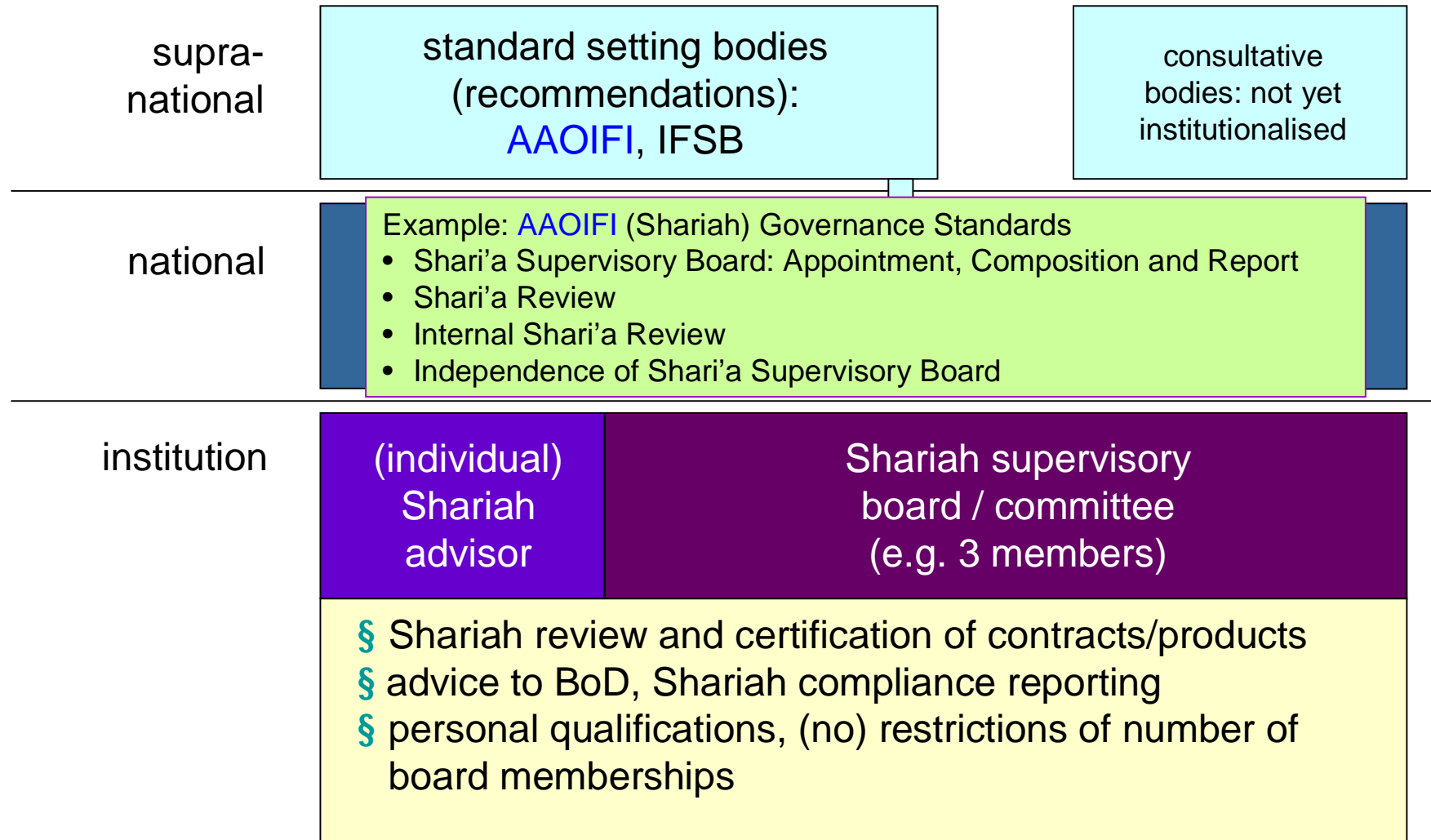
Shariah governance: constitutive for Islamic financial institutions (IFIs)

national	Shariah board / council (of State Bank) with final authority	no Shariah body with final authority
institution	(individual) Shariah advisor	Shariah supervisory board / committee (e.g. 3 members) <ul style="list-style-type: none"> § Shariah review and certification of contracts/products § advice to BoD, Shariah compliance reporting § personal qualifications, (no) restrictions of number of board memberships

Shariah governance: constitutive for Islamic financial institutions (IFIs)

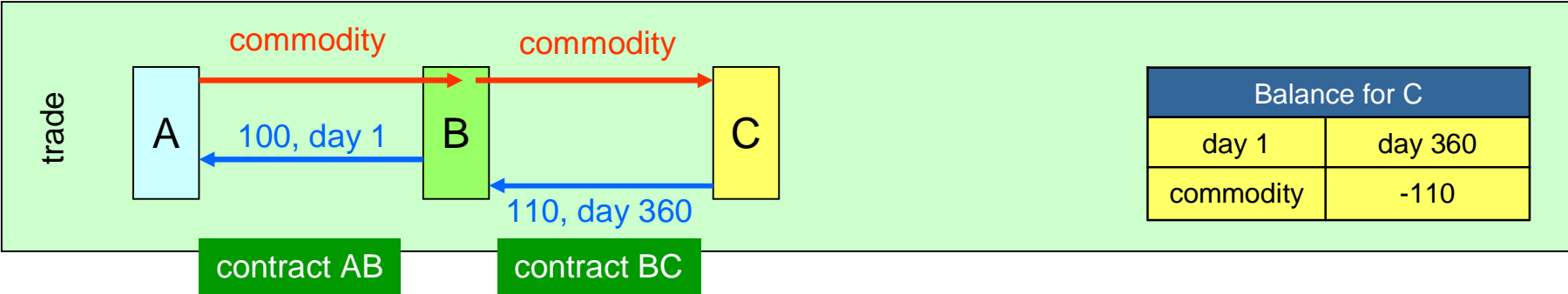


Shariah governance: constitutive for Islamic financial institutions (IFIs)

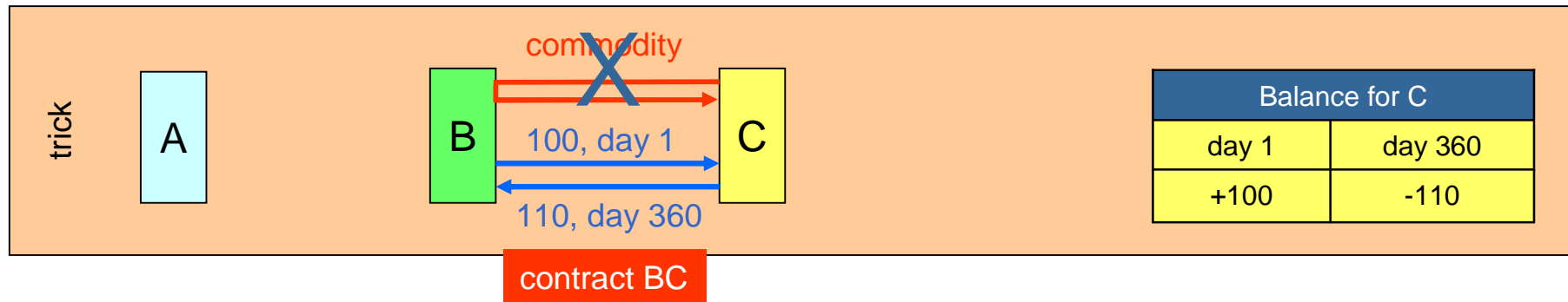
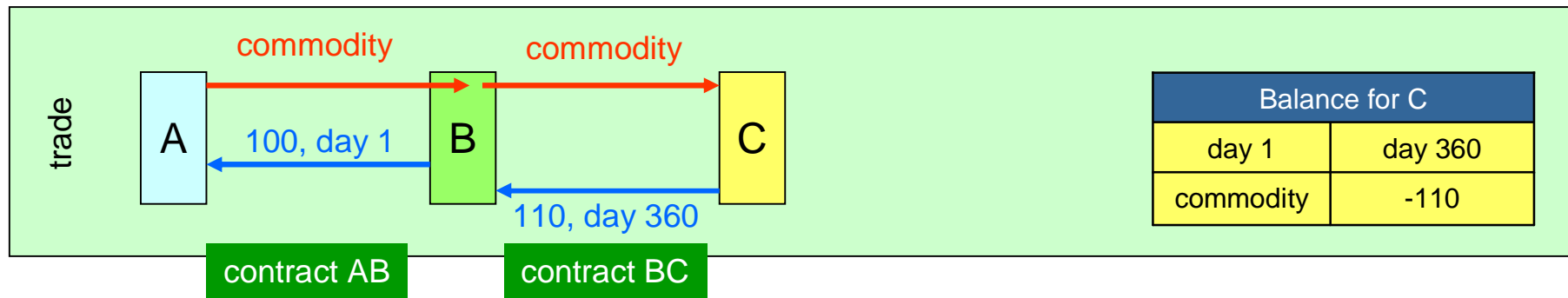


Shariah compliance perspective

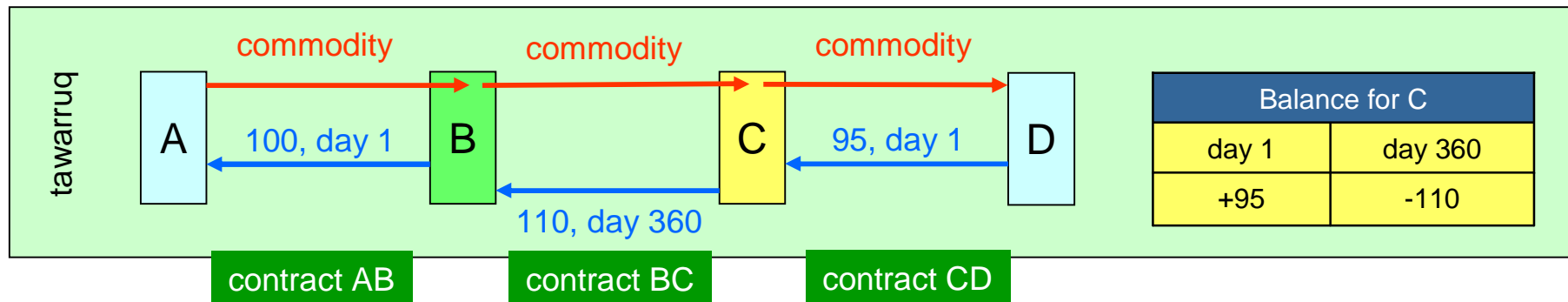
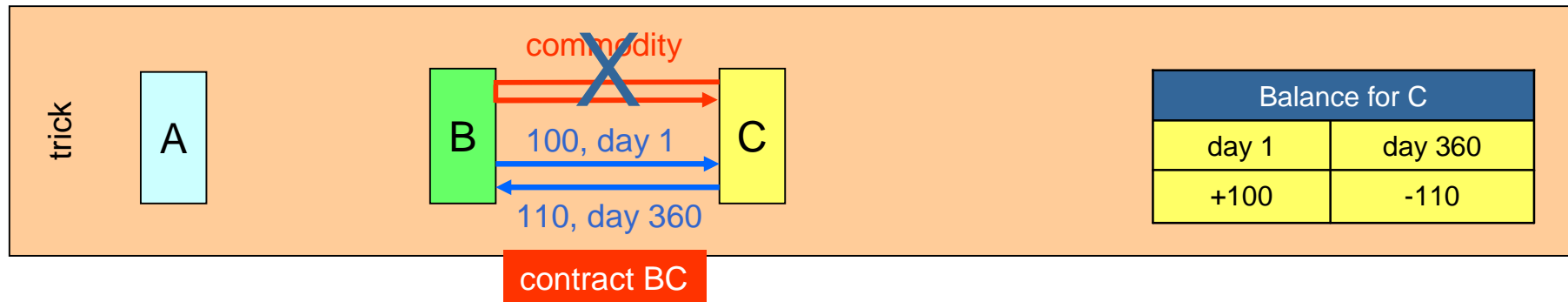
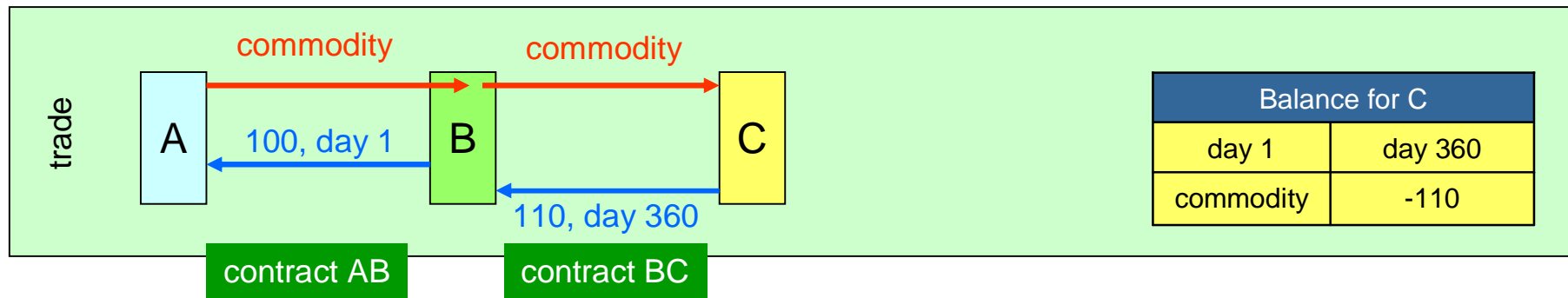
Shariah compliance perspective



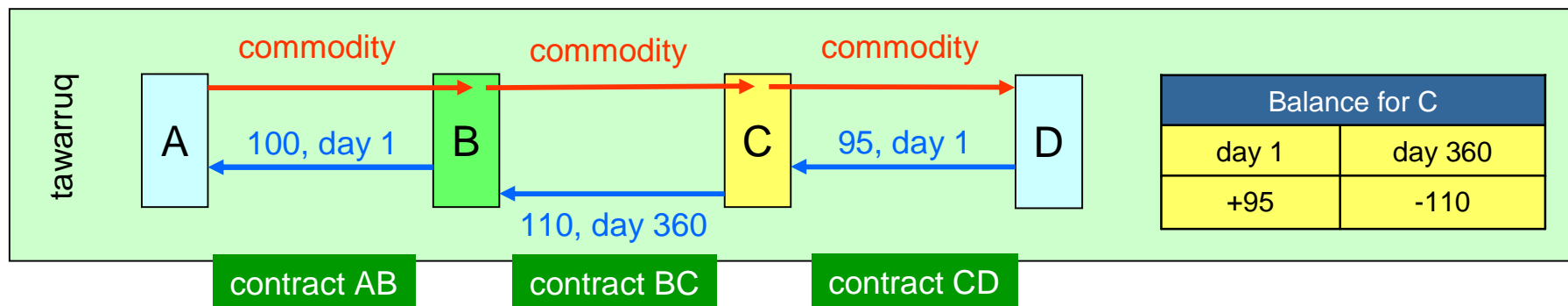
Shariah compliance perspective



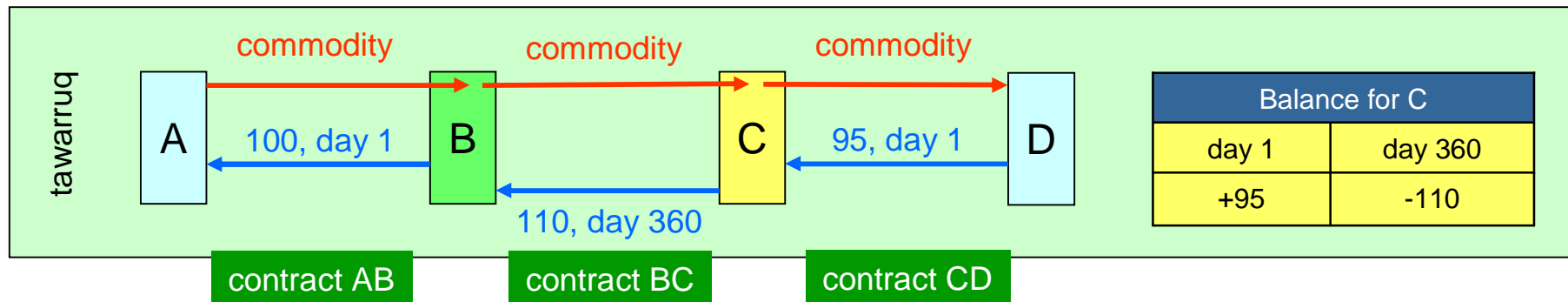
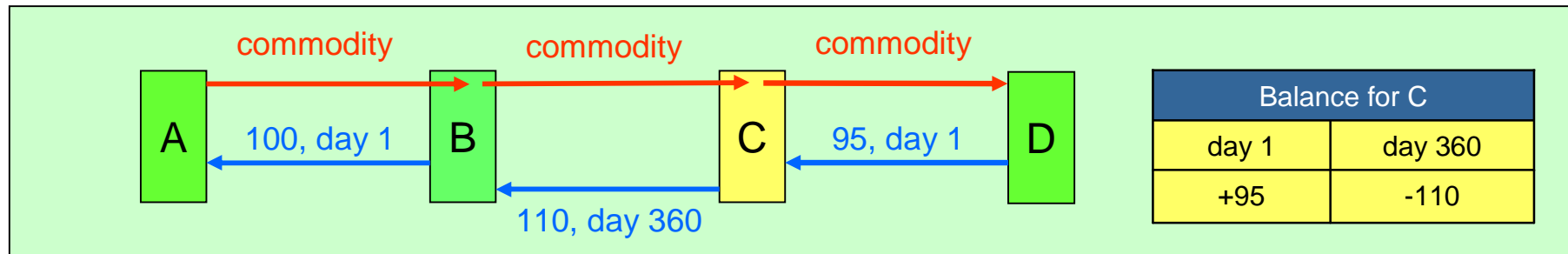
Shariah compliance perspective



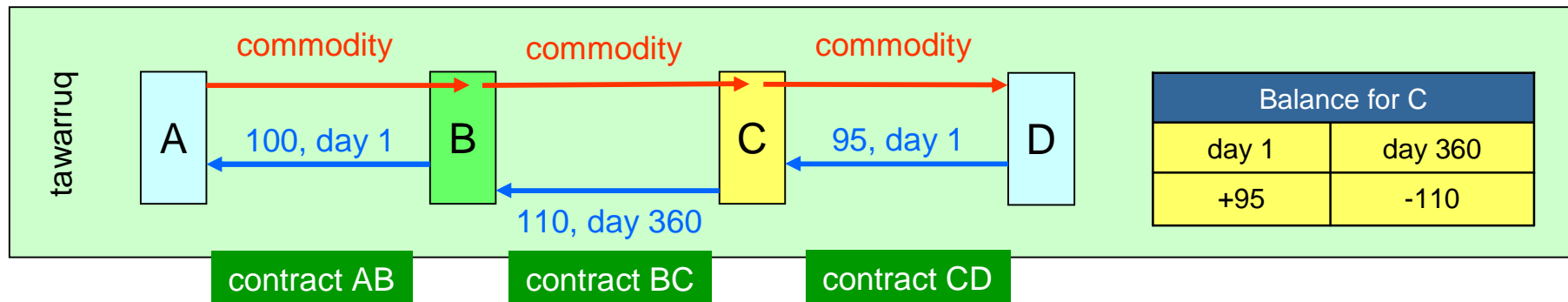
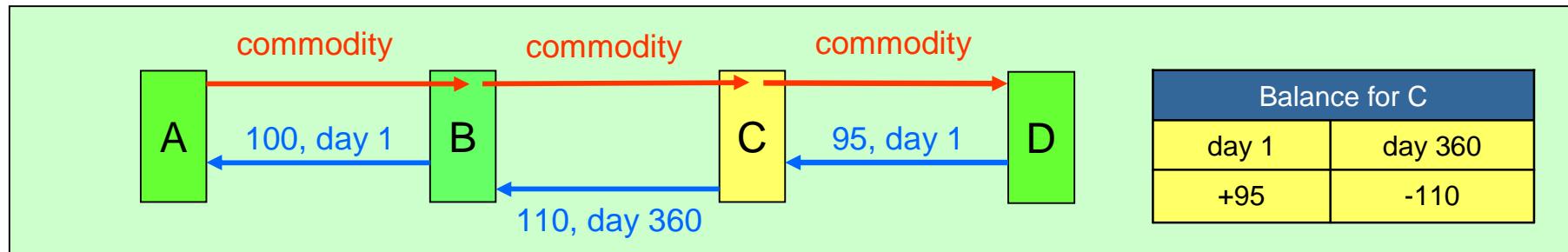
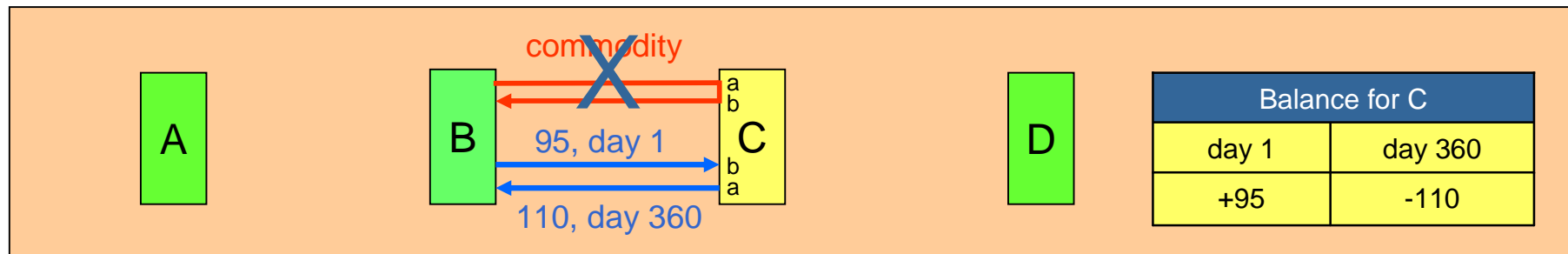
Economic outcome perspective



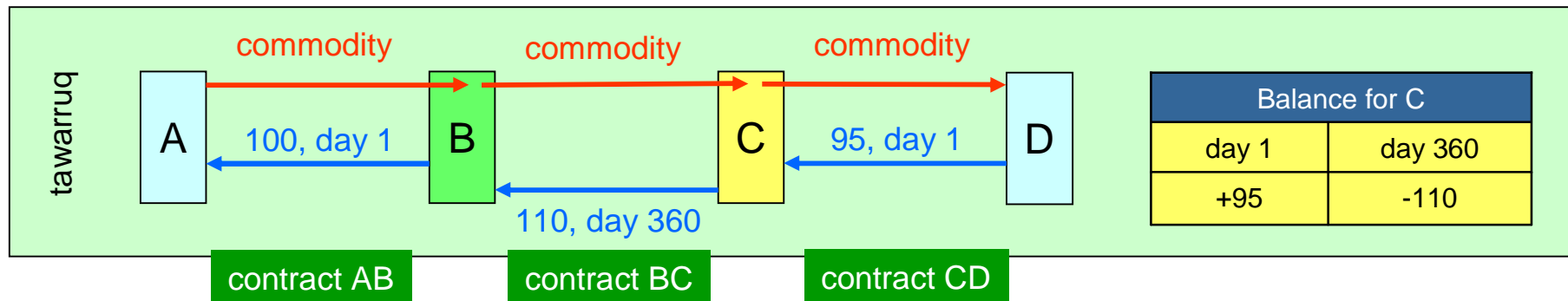
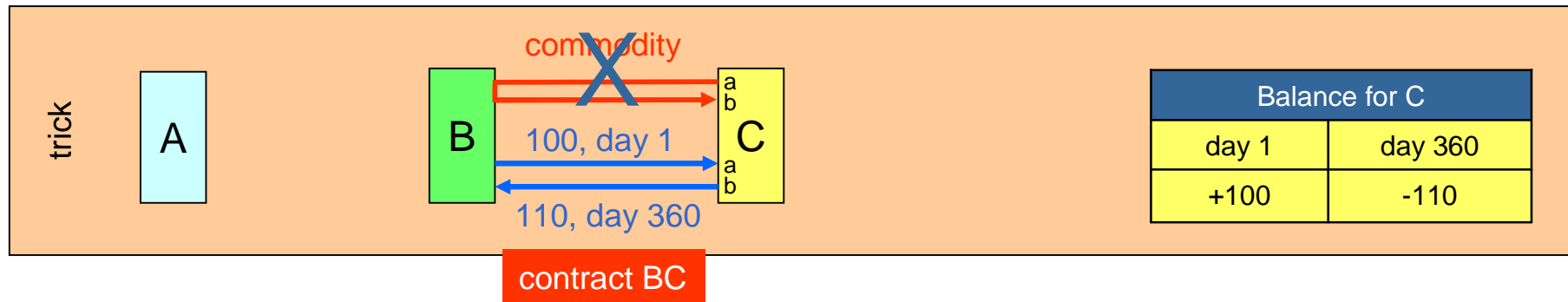
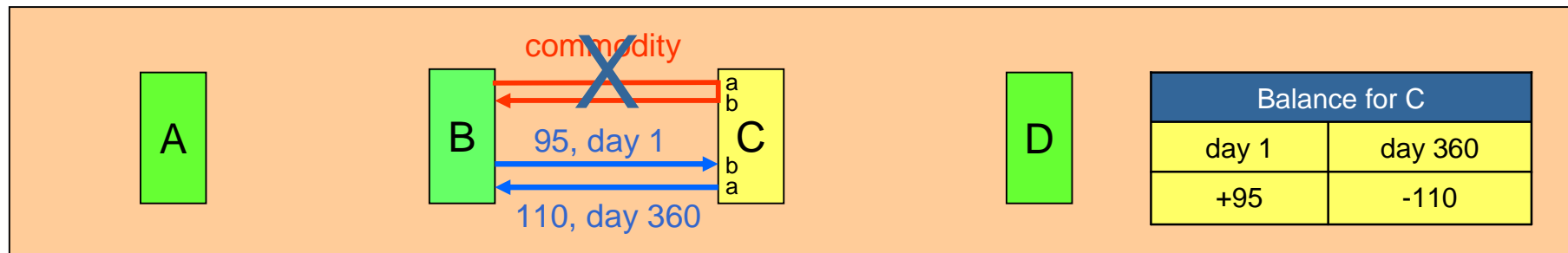
Economic outcome perspective



Economic outcome perspective



Economic outcome perspective



A Short History of Islamic Finance

- 1970s
 - § Islamic economics (strong focus on ideology)
 - § Islamic banking (focus on commercial viability)
- 1980s
 - § discrepancies ideology (PLS) / practice (mark-up)
 - § development of products for individual banks
 - § Islamisation in Pakistan, Sudan, Iran
 - § establishment of new Islamic banks in more countries
- 1990s
 - § instruments for Islamic inter-bank market
 - § instruments for structured finance
 - § accounting and auditing standards
 - § dual banking / Islamic windows in Malaysia
- 2000s
 - § conversion of conventional banks
 - § increasing number of conventional (global) players
 - § supporting infrastructure (law firms, rating agencies, indexes, media, ...)
 - § global standard setting: AAOIFI, IFSB
 - § adaptation of regulations
 - § human capital shortage
 - § strong growth of capital market products (esp. sukuk)

ideological opposition

systemic alternative
(theory of
PLS economy)

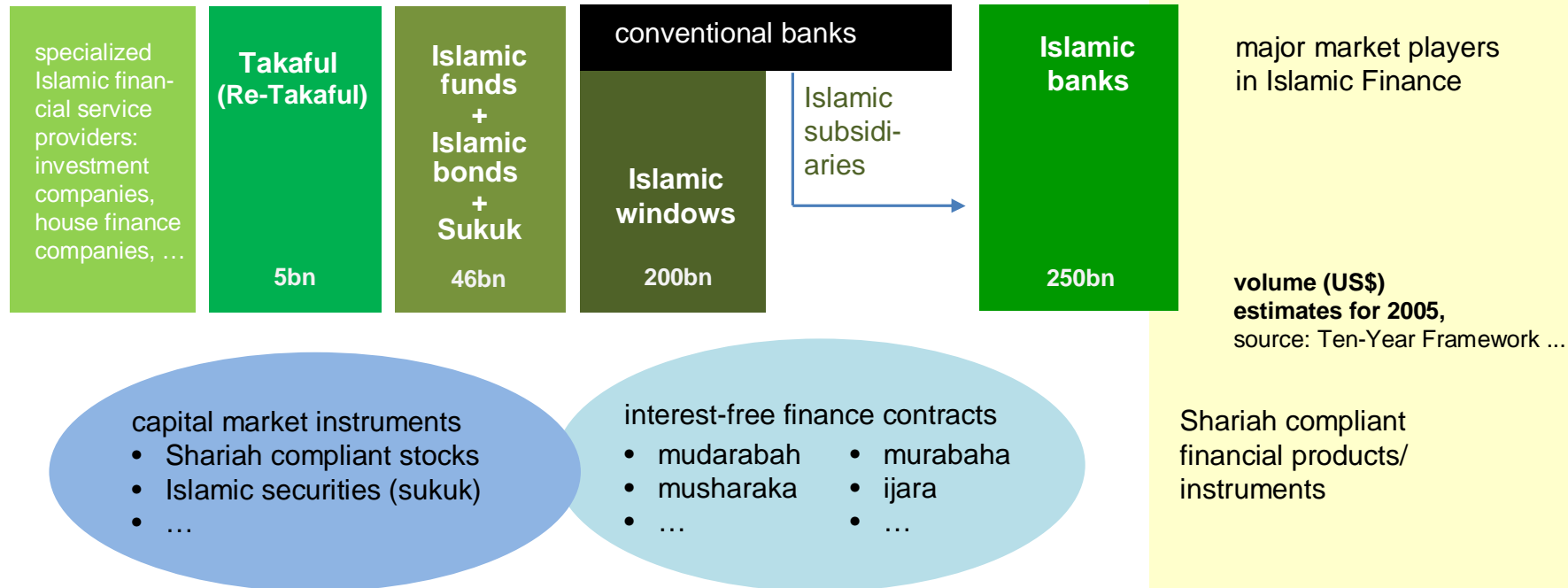
coexistence (reality of
cost-plus financing)

transformation and
convergence
(*tawarruq*)

integration
(*sukuk*)

segment of the
global financial system

Structure, volumes, market shares



Updates and Highlights 2008:

- 300+ Islamic financial institutions 65+ Muslim and non-Muslim countries
- estimated Islamic market potential 4 tn US\$, actual size 700 bn US\$ (17%)
- Sukuk issues expected 20-25 bn US\$ in 2008, total outstanding 70+ bn US\$
- 600+ Shariah compliant funds (est. 59 bn US\$ assets, 50% equity exposures)
- market capitalization of 2300+ companies in DJIM World index 11 tn US\$ (10/2008)
- 140 Takaful operators in 21 countries, 16 Re-Takaful operators (incl. windows)
- Takaful contributions (gross premium written) expected 11 bn US\$ in 2009

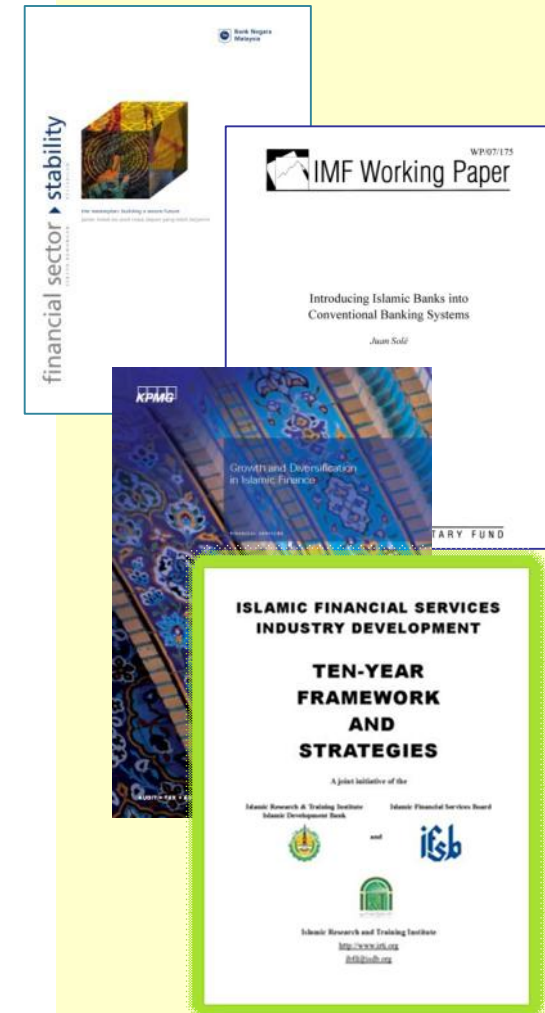
source: Islamic Finance News, various 2008 issues

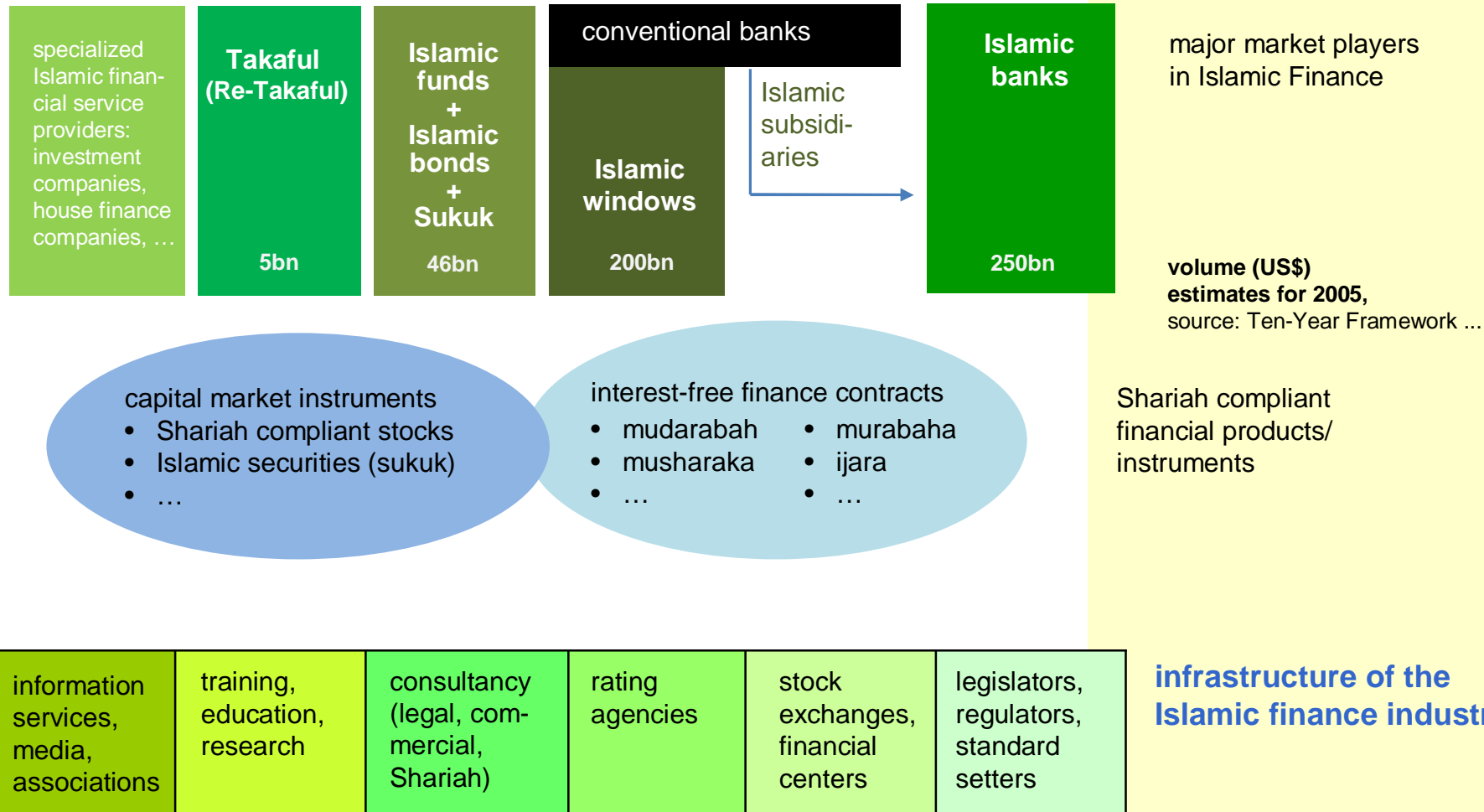


Expected Developments in the IFS industry

- | continued high growth – expected market shares of Islamic financial services by 2015
 - n 50% in GCC countries
 - n 15-25% in South Asian countries
- | industry consolidation (market-driven & mandatory) through mergers and acquisitions
- | new "Islamic mega banks" in the Gulf (equity 1 bn US\$), governments as shareholders
- | Islamic finance for Muslim minorities (Europe, Asia)
- | human resource shortage, new training and study programmes
- | growth of Islamic capital markets, esp. *sukuk* markets (however: slowdown in 2008)
- | better understanding of Islamic finance by the general public (customers) and regulators (including Western countries)
- | robust and fast growth of *takaful*

à **broadening and deepening of Islamic financial markets**





Infrastructure of the Islamic finance industry

legislators,
regulators,
standard
setters

stock
exchanges,
financial
centres

rating
agencies

consultancy
(legal, com-
mercial,
Shariah)

training,
education,
research

information
services,
media,
association

Infrastructure of the Islamic finance industry

legislators, regulators, standard setters	State Bank of Pakistan (SBP), Bank Negara Malaysia (BNM), Central Bank of Bahrain (CBB), ... Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB)
stock exchanges, financial centres	
rating agencies	
consultancy (legal, com- mercial, Shariah)	
training, education, research	
information services, media, association	

Infrastructure of the Islamic finance industry

legislators, regulators, standard setters	State Bank of Pakistan (SBP), Bank Negara Malaysia (BNM), Central Bank of Bahrain (CBB), ... Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB)
stock exchanges, financial centres	Kuala Lumpur Stock Exchange (KLSE), Dubai International Financial Exchange (DIFX), Dubai Financial Market (DFM), International Islamic Financial Market (IIFM), Malaysia International Islamic Financial Centre (MIFC)
rating agencies	
consultancy (legal, commercial, Shariah)	
training, education, research	
information services, media, association	

Infrastructure of the Islamic finance industry

legislators, regulators, standard setters	State Bank of Pakistan (SBP), Bank Negara Malaysia (BNM), Central Bank of Bahrain (CBB), ... Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB)
stock exchanges, financial centres	Kuala Lumpur Stock Exchange (KLSE), Dubai International Financial Exchange (DIFX), Dubai Financial Market (DFM), International Islamic Financial Market (IIFM), Malaysia International Islamic Financial Centre (MIFC)
rating agencies	Standard & Poor's, Moody's, Fitch, Islamic International Rating Agency (IIRA), Rating Agency Malaysia Berhad, Malaysian Rating Corporation (MARC)
consultancy (legal, commercial, Shariah)	
training, education, research	
information services, media, association	

Infrastructure of the Islamic finance industry

legislators, regulators, standard setters	State Bank of Pakistan (SBP), Bank Negara Malaysia (BNM), Central Bank of Bahrain (CBB), ... Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB)
stock exchanges, financial centres	Kuala Lumpur Stock Exchange (KLSE), Dubai International Financial Exchange (DIFX), Dubai Financial Market (DFM), International Islamic Financial Market (IIFM), Malaysia International Islamic Financial Centre (MIFC)
rating agencies	Standard & Poor's, Moody's, Fitch, Islamic International Rating Agency (IIRA), Rating Agency Malaysia Berhad, Malaysian Rating Corporation (MARC)
consultancy (legal, commercial, Shariah)	Norton Rose, Clifford Chance, King & Spalding, Lovells, ... KPMG, Ernst & Young, McKinsey, ... Dar al Istithmar, Yasaar Limited, Dar Al Sharia Legal & Financial Consulting, ...
training, education, research	
information services, media, association	

Infrastructure of the Islamic finance industry

legislators, regulators, standard setters	State Bank of Pakistan (SBP), Bank Negara Malaysia (BNM), Central Bank of Bahrain (CBB), ... Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB)
stock exchanges, financial centres	Kuala Lumpur Stock Exchange (KLSE), Dubai International Financial Exchange (DIFX), Dubai Financial Market (DFM), International Islamic Financial Market (IIFM), Malaysia International Islamic Financial Centre (MIFC)
rating agencies	Standard & Poor's, Moody's, Fitch, Islamic International Rating Agency (IIRA), Rating Agency Malaysia Berhad, Malaysian Rating Corporation (MARC)
consultancy (legal, commercial, Shariah)	Norton Rose, Clifford Chance, King & Spalding, Lovells, ... KPMG, Ernst & Young, McKinsey, ... Dar al Istithmar, Yasaar Limited, Dar Al Sharia Legal & Financial Consulting, ...
training, education, research	Bahrain Institute of Banking and Finance (BIBF), International Centre for Education in Islamic Finance (INCEIF), Institute of Islamic Banking and Insurance (IIBI), International Shariah Research Academy for Islamic Finance (ISRA), ...
information services, media, association	

Infrastructure of the Islamic finance industry

legislators, regulators, standard setters	State Bank of Pakistan (SBP), Bank Negara Malaysia (BNM), Central Bank of Bahrain (CBB), ... Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB)
stock exchanges, financial centres	Kuala Lumpur Stock Exchange (KLSE), Dubai International Financial Exchange (DIFX), Dubai Financial Market (DFM), International Islamic Financial Market (IIFM), Malaysia International Islamic Financial Centre (MIFC)
rating agencies	Standard & Poor's, Moody's, Fitch, Islamic International Rating Agency (IIRA), Rating Agency Malaysia Berhad, Malaysian Rating Corporation (MARC)
consultancy (legal, commercial, Shariah)	Norton Rose, Clifford Chance, King & Spalding, Lovells, ... KPMG, Ernst & Young, McKinsey, ... Dar al Istithmar, Yasaar Limited, Dar Al Sharia Legal & Financial Consulting, ...
training, education, research	Bahrain Institute of Banking and Finance (BIBF), International Centre for Education in Islamic Finance (INCEIF), Institute of Islamic Banking and Insurance (IIBI), International Shariah Research Academy for Islamic Finance (ISRA), ...
information services, media, association	DowJones, FTSE, EurekaHedge, Failaka, ... Euromoney, Islamic Banker, Islamic Finance News, ... General Council for Islamic Banks and Financial Institutions (CIBAFI)

