Top 500 Financial Islamic Institutions listing

The Banker

How fast is the Islamic finance industry growing? The Banker attempts to answer this question with the launch of a new listing: Top 500 Islamic Financial Institutions. The pioneering role of the listing is to provide a benchmark for the future, which can be improved on for the good of the industry. Better disclosure is expected to flow from the publication of listings such as this as greater competition puts pressure on institutions to increase transparency in this area. Stephen Timewell and Joe DiVanna report.

The history of modern Islamic financial institutions is relatively short but quite dynamic. Since the establishment of the Islamic Development Bank and Dubai Islamic Bank in 1975, the idea of interest-free banking and Islamic financial services has become increasingly attractive to the 1.6 billion Muslims across the world. But this decade there has been an explosion of activity in Islamic finance, not only in traditional Muslim regions, but also stretching well beyond. Islamic finance and Islamic financial institutions are fast becoming a major global force and their impact is only just beginning.

How fast is this infant industry growing? What proportion of the global finance industry will be turning to Islamic instruments in the future? Where will the industry be in 2010 and beyond? The key to understanding where Islamic finance will be tomorrow is grasping where it is today. But in a highly fragmented, young market that is emerging within the infrastructure of a western interest-bearing banking system, clear and meaningful figures are difficult to obtain.

Until now, accurate figures across the entire Islamic financial spectrum, covering the range of Islamic financial institutions, banks, investment banks, finance companies and takaful (insurance), and the entire range of geographies, have been sparse at best. Estimates of market size have varied considerably and no verifiable source could provide a reliable global overview of this growing industry.

The Banker publishes the first comprehensive analysis of the Islamic financial industry on a global scale, incorporating 500 Islamic financial institutions from 47 countries. To provide a verifiable benchmark for the entire industry, The Banker has sought to establish the size of sharia-compliant assets across all institutions around the world purporting to provide Islamic financial services (see Methodology below).

The Banker, with the help of Cambridge consultancy Maris Strategies, shows that Islamic finance, which is often largely under-reported, is growing at almost twice the rate of western (interest-related) financial services, and more disclosure is expected to reveal even higher rates of expansion.

Sharia-compliant assets grow fast

This first Top 500 Islamic Financial Institutions (TIFI) listing shows that the global total of sharia-compliant assets, based on the latest official figures, grew by 29.7% over the past year to reach $500,482m. Although this is relatively small compared with the $74,232.2bn in total assets amassed by the Top 1000 World Banks in The Banker's latest global listing (see 7/07, p172), the massive growth taking place in Islamic institutions is unassailable and can be expected to accelerate. The 29.7% growth shown in the TIFI listing, while well above the Top 1000 latest asset growth of 16.3%, appears to vastly under-report the true figure, as a result of many institutions operating in the sector failing to provide even basic data.

This new groundbreaking Islamic listing is based on sharia-compliant assets because at this stage it is the only measurement that is readily available across different financial institutions. In addition to 292 banks, both fully Islamic and those offering Islamic windows or selling Islamic products, there are 115 Islamic investment banks and finance companies, and 118 insurance companies, adding up to a total of 525 institutions from which the Top 500 was drawn.

The key to this listing is the level of disclosure, which reflects the infant nature of the industry. Of the 500 institutions listed, only 318 reported assets and only 221 reported sharia assets, representing 63.6% and 44.3% respectively of the overall listing. These limited figures reflect the current market conditions but analysts believe that the level of disclosure will increase as the industry takes shape and acquires increasing global significance.

While places such as Bahrain, Malaysia and London are putting emphasis on the importance of Islamic finance, reporting practices are evolving slowly and different approaches are being taken. Although there is a clear trend towards uniform, universal reporting standards, the industry still has a long way to go. Institutions such as the Kuala Lumpur-based IFSB (Islamic Financial Services Board) and Manama-based AAOIFI (Accounting and Auditing Organisation for Islamic Financial Institutions) are making progress but more needs to be done.

Nevertheless, this initial listing contains 359 institutions that are operating under full sharia-compliant principles and 141 conventional institutions operating with sharia-compliant windows. It is important to add that The Banker is not evaluating the quality of sharia compliance; if an institution reports that its assets are sharia compliant, we accept it at face value.

Sharia windows on the world

The importance of institutions with sharia windows is growing as some of the world's largest financial institutions, such as Citi, HSBC and Standard Chartered Bank, are focusing on Islamic finance in both the wholesale and retail areas. As sharia-compliant assets have grown within these so-called windows, traditional banks have had to assess how these assets are reported or in many cases not divulged.

A key element of The Banker's new listing is that 'windows' are included as a critical component of the industry. But unfortunately, as our research shows, only one major conventional bank was prepared to disclose its level of sharia-compliant assets. While other major players declined for a variety of competitive and reporting reasons, the UK-based HSBC Holdings was the only major player prepared to disclose its global sharia-compliant assets. Held under the banner of HSBC Amanah, its assets reached $9.7bn at end-June 2007, up 17.2% from $8.3bn at end-June 2006, making HSBC Amanah the 14th largest Islamic financial institution in the world.

Analysing the $500.5bn global market, the six states of the Gulf Cooperation Council (GCC – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) provide the largest chunk of the total but the non-GCC Middle East and north Africa (MENA) states are not far behind. While the overall total grew by 29.7% to $500.5bn in the listing, the GCC institutions expanded the most by 39.4% to $178.1bn and the non-GCC MENA institutions grew by 29.9% to reach $176.8bn.

Asia, led by Malaysia, Brunei and Pakistan, is the third largest region in the world for sharia-compliant assets, growing by 20.9% to $119.3bn. The grouping of institutions from Australia, Europe and North America account for $21.5bn with sub-Saharan African institutions accounting for $4.7bn in assets.

Looking at the overall global total, the MENA region accounts for a huge 70.9% of the $500.5bn total, split almost evenly between the GCC states with 35.6% and the non-GCC MENA states with 35.3%. Asia comes in third with 22.7% of the market.

Iran leads on asset levels

Analysing the listing, the country with the highest level of sharia-compliant assets is undoubtedly Iran, which tops the country ranking with assets of $154.6bn (see table, page 4). Iran, which claims that its financial institutions are 100% sharia compliant, has more than double the amount of its nearest competitors, Saudi Arabia with $69.4bn and Malaysia with $65.1bn. Although both Saudi Arabia and Malaysia may have bigger banking sectors than Iran (see page 22), our research shows that in terms of sharia-compliant assets they are considerably smaller. This is because Saudi and Malaysian sharia-compliant assets as a percentage of total assets are only 31.6% and 25.1% respectively. Although Islamic products are growing fast in the Saudi and Malaysian markets, especially in retail – as they are in other leading markets such as Kuwait, UAE and Bahrain – the sharia-compliant component is still relatively low by comparison with Iran, Brunei and Turkey, which define themselves as 100% sharia compliant.

In the future, as sharia-compliant assets (SCAs) become a larger percentage of the overall financial sectors in a number of countries, as expected, Iran's dominance of the Islamic market will be lessened. Also, these figures demonstrate the huge growth potential that is yet to be realised. For example, if the percentage of Saudi and Malaysian SCAs is tripled to 91.8% and 75.3% respectively, as is thought possible in the years ahead, there would be more than a 50% increase in the current $500.5bn aggregate total. As the trend towards Islamic finance grows, there will be an exponential growth in SCAs worldwide, especially as Muslim countries increase their proportion of sharia-compliant assets held.

UK makes its mark

The Top 15 countries table includes the UK, a non-Muslim nation, in 10th place with sharia-compliant assets of $10.4bn. This is mostly HSBC Amanah, the vehicle for HSBC Holdings' global SCAs, which total $9.7bn. The UK's extensive financial services capability and government support for Islamic finance is moving London towards becoming a major hub for Islamic financing on a global scale. There is also growing competition between Malaysia, Bahrain and Dubai, which are also promoting their credentials as Islamic finance hubs.

Examining the Top 500 institutional listing closely, the Iranian banks dominate the top positions, accounting for six of the Top 20 places. Bank Melli Iran and Bank Saderat Iran head the ranking with SCAs of $35.5bn and $34.8bn respectively. Brunei-based insurance company Takaful IBB Berhad comes third on $31.5bn followed by Saudi Arabia's largest Islamic institution, Al Rajhi Bank, on $28.1bn. The rest of the Top 20 consists of three other banks from Saudi Arabia, three from Malaysia, two from UAE and the UK's HSBC Amanah in 14th place.

Reporting is limited

According to the Top 500 listing, 221 institutions have reported sharia assets, which is only 42.1% of the industry. Although it is easy to criticise the fact that many institutions listed do not have data available, the key pioneering role of the listing is to provide a benchmark for the future. The Banker believes that the Top 500 contains the most comprehensive listing of Islamic institutions yet to be published. The lack of data available is part of the general teething problems associated with the industry and the lack of disclosure overall is taking place among both pure Islamic institutions and so-called 'windows' of conventional institutions.

Improved disclosure is expected to flow from the publication of listings such as the Top 500 as greater competition puts pressure on institutions to increase transparency. In the wholesale markets, for example, Bloomberg's underwriting league tables of Islamic bonds and loans provides a good example of the growth and range of market players in this key Islamic sector. The 58.5% growth in volume in the first 10 months of 2007 (see table) demonstrates the growing appeal of Islamic financing to non-Muslim institutions and investors.

This first Top 500 Islamic financial institutions listing could have contained much richer data if the data was made available. Nevertheless, a key benchmark has been set and can only be improved upon in the future for the good of the industry.

TOP 20 INSTITUTIONS BY SHARIA-COMPLIANT ASSETS

TOP 15 COUNTRIES BY SHARIA-COMPLIANT ASSETS

Rank 2007	Country	Shariah-compliant assets ($m)
1	Iran	154,616.28
2	Saudi Arabia	69,379.15
3	Malaysia	65,083.37
4	Kuwait	37,684.47
6	Brunei	31,535.19
5	UAE	35,354.36
7	Bahrain	26,251.86
8	Pakistan	15,918.21
9	Lebanon	14,315.82
10	UK	10,420.47
11	Turkey	10,065.96
12	Qatar	9,459.71
14	Bangladesh	4,331.90
15	Egypt	3,852.86

Source: The Banker

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Source: **The Banker**

Investment banks and insurance firms in the net

Islamic finance covers many areas and in this exercise The Banker did not want to exclude any Islamic financial institution. Clear definitions of what constitutes a non-bank institution need to be improved but we wanted to include not only investment banking operations and Islamic investment companies, as distinct from banks, but also Islamic insurance operations.

These types of institutions are excluded from The Banker's Top 1000 World Banks listing but in the Top 500 Islamic Financial Institutions listing, the objective was to chart all Islamic institutions, whatever the product. Hence we include Top 25 listings of investment banking activities and Islamic insurance (takaful).

Of the 525 institutions assessed for the Top 500, 115 fell into the category of investment bank, investment company or asset manager. Among the Top 25 below, 20 come from the six Gulf Cooperation Council (GCC) states, showing the strength of the Gulf institutions in this area. But definitions can again be a problem and some would argue whether the leading player listed, Saudi Arabia's Al Rajhi Bank, is more a commercial bank than an investment bank. Also at this stage, we do not have the specific figures to reflect HSBC Amanah's sizeable investment banking role. The Top 25 shows that Bahrain has the largest number of leading Islamic investment banks, with nine, and Kuwait has six 100% sharia-compliant investment houses. While most of the Top 25 are well-established outfits, they remain relatively small, as their figures suggest, compared with many foreign-owned or conventional investment houses operating in the region.

In the insurance sector, the Top 25 is dominated by Brunei's Takaful IBB Bd, which claims $31.5bn in sharia-compliant assets (SCAs) in the insurance area. Nothing comes remotely close to the Brunei giant; Iran Insurance Company is in second place with SCAs of $1.5bn and Malaysia's Syarikat Takaful Malaysia Bd coming in third with $825.8m. Again, the GCC companies figure prominently, providing 12 of the Islamic insurance institutions, led by Saudi Arabia's Company for Cooperative Insurance. In this market, the leading players are more widely spread, with institutions coming from as far afield as Senegal, Sudan, Bangladesh and Tunisia. Although the Islamic firms are growing, many remain pitifully small.

TABLE: TOP 25 ISLAMIC INVESTMENT BANKS

TOP 25 ISLAMIC INVESTMENT BANKS

Ranking by RoA	Top 500	Institution	Country	Sharia compliant assets $m
1	4	Al Rajhi Bank	Saudi Arabia	28,093.12
2	29	Qatar Islamic Bank	Qatar	4,090.25
3	30	Investment Dar	Kuwait	3,978.00
4	32	ABC Islamic Bank	Bahrain	3,484.00
5	34	Ithmaar Bank BSC	Bahrain	3,179.94
6	40	Arcapita Bank	Bahrain	2,707.71
7	42	Qatar International Islamic Bank, Doha	Qatar	2,307.12
8	54	Shamil Bank	Bahrain	1,693.26
9	55	Aayan Leasing and Investment Co.	Kuwait	1,642.18
10	56	Gulf Finance House BSC	Bahrain	1,631.02
11	63	National Investment Trust, Karachi	Pakistan	1,248.40
12	64	Masraf Al Rayan	Qatar	1,188.00
13	65	AREF Investment Group	Kuwait	1,179.60
14	70	Qatar Real Estate Investment Co.	Qatar	1,043.10
15	77	Kuwait Finance House (Malaysia) Bd	Malaysia	855.49
16	91	Banque Al Baraka D'Algerie	Algeria	564.10
17	92	Al Baraka Islamic Investment Bank	Bahrain	559.66
18	93	The International Investor, Safat	Kuwait	549.86
19	94	Khaleej Finance & Investment Co.	Bahrain	519.67
20	95	Al Salam Bank	Bahrain	500.15
21	97	First Investment Company	Kuwait	482.40
22	99	European Islamic Investment Bank	UK	463.82
23	101	Al Amin Bank	Bahrain	430.94
24	104	Gulf Investment House	Kuwait	388.27
25	107	AmInvestment Group Bd	Malaysia	353.93

Source: **The Banker**

TABLE: TOP 25 ISLAMIC INSURANCE COMPANIES

TOP 25 ISLAMIC INSURANCE COMPANIES

Ranking by RoA	Top 500	Institution	Country	Sharia compliant assets $m
1	3	Takaful IBB Berhad	Brunei	31,535.19
2	60	Iran Insurance Company	Iran	1,515.98
3	79	Syarikat Takaful Malaysia Bd	Malaysia	825.82
4	82	The Co. for Co-operative Insurance	Saudi Arabia	733.27
5	105	Islamic Arab Ins. Company-Salama	UAE	375.39
6	118	B.E.S.T. Retakaful	Tunisia	279.88
7	129	Solidarity Insurance Company	Bahrain	227.13
8	140	Alborz Insurance Company	Iran	189.82
9	141	Al Khaleej Insurance & Reinsurance Co.	Qatar	189.43
10	145	Qatar Islamic Insurance Company	Qatar	125.93
11	148	Sheikan Ins. & Reinsurance Co.	Sudan	105.689
12	149	Takaful Ikhlas Sdn Bhd	Malaysia	99.62
13	159	Saudi Arabian Insurance Co.	Saudi Arabia	67.80
14	161	Abu Dhabi National Takaful Co	UAE	65.12
15	163	Gulf Takaful Insurance Company	Kuwait	61.00
16	169	First Takaful Insurance Company	Kuwait	54.78
17	173	Takaful International Company	Bahrain	38.50
18	179	Asean Retakaful International	Malaysia	26.09
19	180	Farest Islami Life Insurance	Bangladesh	25.78
20	183	Arabia ACE Insurance Co.	Bahrain	21.65
21	185	Karafarin Insurance Company	Iran	20.94
22	188	PT Asuransi Syari'a Mubarakah	Indonesia	14.86
23	190	Islamic Insurance Company	Sudan	13.21
24	191	Allied Cooperative Insurance Group	Saudi Arabia	11.95
25	193	SOSAR AL AMANE	Senegal	10.51

Source: **The Banker**

Growth attracts new players

In this vibrant young industry, many new players are emerging. The combination of huge liquidity in the Gulf region from oil prices in excess of $80 a barrel and the attraction of new opportunities through Islamic finance has led to a large expansion of Islamic institutions both in the Gulf and elsewhere.

Since the beginning of 2006, The Banker has listed 78 new Islamic financial institutions formed or under formation (u/f). They include Bank of London and the Middle East, set up in the UK in July this year; Islamic Bank of Asia, a subsidiary of DBS Bank, set up in Singapore in May; Boubyan Takaful Insurance Company, set up in Kuwait in June last year; and AmIslamic Bank Berhad, set up in April 2006 in Malaysia, which has the highest sharia-compliant assets ($22,263.25m) among the new entrants.

Only 11 of these 78 were able to provide basic figures but the strong range of product categories and diverse geographic spread, from Yemen to Afghanistan, clearly demonstrates the expansion potential in the industry. And with 47 of the 78 from the six Gulf Cooperation Council (GCC) states, the GCC will remain a key growth area.

TABLE: LATEST ENTRANTS - ISLAMIC FINANCIAL SINCE 2006

LATEST ENTRANTS – ISLAMIC FINANCIAL SINCE 2006

Latest	Institution	Country	Service started	Sharia-compliant assets $m
1	Jaber Islamic Bank	Kuwait	u/f	n/a
2	The International Islamic Union Bank	Yemen	u/f	n/a
3	Tayseer Bank	France	u/f	n/a
4	Bear Stearns Arabia Asset Managem't	Saudi Arabia	u/f	n/a
5	British Islamic Insurance Holdings	UK	u/f	n/a
6	Saudi IAIC Co-operative Insurance Co	Saudi Arabia	Oct-06 (2001 in Bahrain)	n/a
7	Gulf African Bank	Kenya	Sep-07	n/a
8	Bank of London and the Middle East	UK	Jul-07	n/a
9	Amlak Int'l for Real Est. Dev't & Fin. Co.	Saudi Arabia	Jun-07	n/a
10	Global Banking Corporation	Bahrain	Jun-07	n/a
11	Amlak Finance and Real Est. Invest.	Egypt	Jun-07	n/a
12	The First Community Bank Ltd	Kenya	Jun-07	n/a
13	Daman Investments	UAE	08-May-07	n/a
14	Islamic Bank of Asia	Singapore	May-07	n/a
15	Kotak Mahindra Asset Managem't Co.	India	May-07	n/a
16	Sabaek	Kuwait	Apr-07	n/a
17	Kuwait Financial Centre (Markaz)	Kuwait	Mar-07	n/a
18	Noor Takaful Insurance	Syria	Mar-07	n/a
19	Allianz Takaful (Bahrain) BSC	Bahrain	Mar-07	n/a
20	First National Bank of Botswana	Botswana	Mar-07	n/a
21	Capital Management House	Bahrain	6-Feb-07	n/a
22	Aseel Finance	UAE	Feb-07	n/a
23	Emirates Global Islamic Bank Ltd	Pakistan	Feb-07	58.00
24	Asian Finance Bank Berhad	Malaysia	19-Jan-07	205.22
25	Al Aqeelah Takaful Insurance Co.	Syria	Jan-07	n/a
26	Al Hilal bank (the Crescent Bank)	UAE	2007	n/a
27	Dubai Bank (Masref Dubai)	UAE	2007	1513.71
28	Syrian Qatar Takaful Insurance	Syria	2007	n/a
29	First Dawood Islamic Bank Ltd	Pakistan	2007	59.83
30	ABN AMRO Pakistan	Pakistan	2007	2.91
31	Noor Islamic Bank	UAE	2007	n/a
32	Mawarid Finance	UAE	Dec-06	n/a
33	UBL(United Bank Limited) Ameen	Pakistan	Dec-06	27.06
34	Sakana Holistic Housing Solutions BSC	Bahrain	Dec-06	n/a
35	Alahli Takaful Company	Saudi Arabia	Dec-06	n/a
36	Al Ahlia Insurance Co. for Co-op. Insurance	Saudi Arabia	Nov-06	n/a
37	Injazat Capital	UAE	Nov-06	n/a
38	Masraf Al Rayan | Al Rayan Bank	Qatar	Oct-06	1,188.00
39	Al Sanabel Int'l Co. For Islamic Fin. Invest.	Jordan	Oct-06	n/a
40	Saudi Fransi Co-operative Insurance Co.	Saudi Arabia	Oct-06	n/a
41	Albilad Islamic Bank	Iraq	Oct-06	n/a
42	SABB Takaful	Saudi Arabia	Oct-06	n/a
43	Cham Bank	Syria	Sep-06	n/a
44	Commercial Bank International	UAE	Sep-06	n/a
45	Jadwa Investment	Saudi Arabia	21-Aug-06	n/a
46	Al Fajer Retakaful Insurance Co.	Kuwait	Jul-06	n/a
47	Kenya Commercial Bank	Kenya	Jul-06	n/a
48	Masrafy	Bahrain	Jun-06	n/a
49	Al Ritaj Investment Company	Kuwait	Jun-06	n/a
50	Boubyan Takaful Insurance Co.	Kuwait	Jun-06	n/a
51	AmIslamic Bank Berhad	Malaysia	Apr-06	22,263.25
52	Kabul Bank	Afgahnistan	Apr-06	n/a
53	Al Salam Bank	Bahrain	Jan-06	500.15
54	Gulf Union Co-operative Insurance Co.	Saudi Arabia	oc 06	n/a
55	Mashreqbank, UAE	UAE	2006 (1967)	n/a
56	Al Masref	Bahrain	2006	n/a
57	Abu Dhabi Commercial Bank	UAE	2006	n/a
58	Syrian International Islamic Bank	Syria	2006	n/a
59	Kuwait International Bank Kuwait	Kuwait	2006	2779.10
60	United International Bank	Bahrain	2006	314.22
61	Al Aqeelah Finance Leasing and Invest. Co.	Kuwait	2006	n/a
62	Shuaa Capital	UAE	2006	n/a
63	Amlak Investments	UAE	2006	n/a
64	Al Wifaq Finance Company	UAE	2006	n/a
65	National Bank of Pakistan	Pakistan	2006	1.70
66	Gulf One Investment Bank	Bahrain	2006	n/a
67	Albaraka Bank Syria	Syria	2006	n/a
68	KSB Capital Group	Saudi Arabia	2006	n/a
69	First Finance Company -Jordan	Jordan	2006	n/a
70	Dubai Islamic Bank Pakistan Ltd	Pakistan	2006	243.99
71	Prime Commercial Bank	Pakistan	2006	5.80
72	Al Safwa Islamic Financial Services	UAE	2006	n/a
73	First Insurance	Jordan	2006	n/a
74	AIG Takaful-Enaya	Bahrain	2006	n/a
75	Dlala Islamic Brokerage Company	Qatar	2006	n/a
76	Sharjah Islamic Financial Services	UAE	2006	n/a
77	Al Ain Takaful Insurance Company	Kuwait	2006	n/a
78	Badr Al-Islami Banking	UAE	2006	n/a

Source: The Banker

Compliance levels grow at astounding rates

The Top 15 countries in the world by sharia-compliant assets (SCAs) are determined not only by the size of each country's financial sector but also the degree to which it is sharia compliant.

As economies evolve and financial institutions do more business through Islamic or sharia-compliant channels, leading countries such as Saudi Arabia, Malaysia and Kuwait will rise up the rankings. At present, the share of the above three countries' SCAs as a proportion of total assets is relatively low at 31.58%, 25.11% and 37.3% respectively, well below the 100% sharia compliance declared by the Iranian institutions.

The Banker believes that as Islamic finance evolves these proportions, low at present, will move much closer to those of 100% countries such as Iran, Brunei and Turkey. The infant nature of the markets in some cases and the difficult political process in terms of the transition from conventional finance to sharia-compliant products provides some anomalies in how some institutions and countries are shown in this first listing. The only certainty appears to be that subsequent listings will look significantly different as more data from all parties becomes available.

Clearly with countries such as Egypt, 15th in our ranking, which has a large financial sector of $57.9bn but only $3.9bn (6.7%) of that in SCAs, there is room for massive growth in Islamic finance, which is likely to take place in the years ahead.

To relate the high growth potential of Islamic finance to the high population areas of countries such as Indonesia, Egypt, Iran and Turkey, we have included maps (see pages 30 and 31) to help provide a broader global assessment.

Meanwhile, here we include two Top 15 growth tables showing both the percentage growth and the value of increased SCAs. In the percentage table, Malaysia's Bank Perusahaan showed massive growth in SCAs. This table includes a number of insurance companies, such as Sudan's Watania Co-operative Insurance and El Nilein Insurance, which both showed growth in excess of 300%. In the volume table, Iranian banks are the key driver, led by Bank Melli Iran, but large Gulf Islamic banks, Dubai Islamic Bank and Kuwait Finance House also figure prominently.

From niche to mainstream

The Islamic finance industry is rapidly evolving and expanding, with growth of banking assets estimated at $750bn and growing at a rate of 15% to 20% a year. Nabeel Shoaib explains.

The growth of Islamic finance is outpacing almost every other business segment of the global banking system. Sharia-compliant banking for Islamic retail clients was introduced only a decade ago (corporate banking has been around a lot longer), yet the past four years have seen exponential growth of the business, particularly in Saudi Arabia, where 95% of all retail banking transactions are now done through Islamic banking institutions. Other markets with a vast potential, such as Malaysia and Indonesia, are moving dynamically through a development stage. The Malaysian and east Asian markets show a great deal of promise, as they tend to be highly sophisticated with a more developed infrastructure than the Middle East and a more liberal sharia interpretation.

At the retail end, there is already a flourishing array of products available to Muslim customers. The offering includes sharia-compliant home and auto finance, current and savings accounts, debit and credit cards and investment products such as equity funds, property funds and capital-protected funds.

Islamic finance is not a new phenomenon. It has been practised since the Middle Ages, but has risen in prominence over the past 30 years or so. This is largely due to the growing financial resources of oil-producing countries in which Islam is the main religion, increasing wealth and financial sophistication, as well as increasing demand for financial services. In recent times, just as there is an increasing interest in the western world in ethical finance, the emerging Islamic banking sector has achieved acceptance and funds managed by Islamic institutions continue to grow and flourish.

Fundamental principles

Islamic finance has been adopted to meet the needs of specific countries and societies, but the overarching principle is that all forms of interest are forbidden. The Islamic financial model works on the basis of risk sharing. The customer and the bank share the risk of any investment on agreed terms, and divide any profits between them. The main categories within Islamic finance are: ijara, ijara-wa-iqtina, mudaraba, murabaha and musharaka. Ijara is a leasing agreement whereby the bank buys an item for a customer and then leases it back over a specific period. Ijara-wa-iqtina is a similar arrangement, except that the customer is able to buy the item at the end of the contract. Mudaraba offers specialist investment by a financial expert in which the bank and the customer shares any profits. Customers risk losing their money if the investment is unsuccessful, although the bank will not charge a handling fee unless it turns in a profit. Murabaha is a form of credit that enables customers to make a purchase without having to take out an interest-bearing loan. The bank buys an item and then sells it on to the customer on a deferred basis. Musharaka is an investment partnership in which profit-sharing terms are agreed in advance, and losses are pegged to the amount invested.

Today’s Islamic finance industry is rapidly evolving from niche to mainstream, with growth of Islamic banking assets now estimated at $750bn and growing at a rate of 15% to 20% a year. The Gulf Co-operation Council (GCC) proportion of total Islamic banking assets has reached 30% and is projected to rise to 40% in the next three years. In Malaysia, the Islamic share is currently 12% and the government is committed to boosting this to 20% by 2010. In Islamic countries such as the United Arab Emirates (UAE), where less than 30% of the local population are Arabs, sharia-compliant banks are gaining market share at the expense of conventional banks.

The spectacular acceptance and demand for Islamic finance means that within the next decade, the industry is likely to capture half the savings of the 1.6 billion-strong Muslim world. It is tempting to assume that the growth is being fuelled by an older generation of Muslims keen to take advantage of an offering that complies with their traditional way of life. Not so: the vast majority of the uptake comes from the under-30 segment of the Islamic world, and it is this segment that holds the key to success for the more than 250 Islamic banks that now operate in more than 75 countries worldwide. The popularity of Islamic finance among these young Muslims responds to a resurgence of interest in their cultural and religious identity. This ‘baby boom’ of customers makes up the backbone of the industry.

The Islamic finance industry infrastructure is supported by several international bodies. One is the Islamic Financial Services Board (IFSB). This is an international standard-setting organisation that promotes and enhances the soundness and stability of the Islamic financial services industry by issuing global prudential standards and guiding principles for the industry, broadly defined to include banking, capital markets and insurance sectors. The IFSB also conducts research and co-ordinates initiatives on industry-related issues, as well as organises round tables, seminars and conferences for regulators and industry stakeholders. The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) is an Islamic international autonomous not-for-profit corporate body that prepares accounting, auditing, governance, ethics and sharia standards for Islamic financial institutions and the industry.

Professional qualification programmes are presented by AAOIFI in its efforts to enhance the industry’s human resources base and governance structures. As an independent international organisation, AAOIFI is supported by more than 155 institutional members from 40 countries, including central banks, Islamic financial institutions, and other participants from the international Islamic banking and finance industry, worldwide. AAOIFI has gained support for the implementation of its standards, which are now adopted in Bahrain, Dubai International Financial Centre, Jordan, Lebanon, Qatar, Sudan and Syria.

The Islamic International Rating Agency (IIRA) was established to provide capital markets and the banking sector in predominantly Islamic countries with a rating spectrum that encompasses the full array of capital instruments and speciality Islamic financial products, and to enhance the level of analytical expertise in those markets. IIRA’s rating system recognises and incorporates the unique features of Islamic finance in a way that broadens the quality perspective that is a rating agency’s ultimate goal. This will facilitate development of the company’s markets. The business model employed, focused on the needs of institutional investors, predicates value creation for ratings on the premise that investors will ultimately demand the company’s ratings and research. IIRA has received formal recognition from one multi-lateral development bank. This business model defines the prerequisites for establishment of the agency: independence of rating judgement, objective and impartial rating committees, highly-trained professional analytical staff and business objectives determined by the market.

Islamic finance in the UK

The global momentum of Islamic finance is not limited to the Arab world. The UK, home to some two million Muslims, is making a bid to compete with Islamic finance centres such as Bahrain, Dubai and Riyadh. The British government's stated aim is to make London a global centre for financial markets in the Middle East, north Africa and other Muslim countries around the world. It has recognised the vast potential of this market and in 2003 it began shaping the tax and regulatory framework to allow for the development of Islamic finance products. One of the first initiatives was to remove the double stamp duty land tax charge on Islamic mortgages, while in 2005 it legislated to bring these products within the existing mortgage regime.

London has also emerged as the centre for secondary market trading in Islamic instruments. The City is home to many of the originating banks, as well as the hedge fund and real money investors that have recently bought into Islamic bonds. Sukuk (bonds) are structured such that investors have a beneficial interest in the cash flows generated by the underlying assets. Assets are sold by the original to a special purpose vehicle (SPV) in the form of a trust. The size of the sukuk market, encompassing domestic and international issues, is estimated at about $60bn. The market is expanding at a rapid pace, with last year's $20bn issuance representing a rise of almost 50% over 2005. Hence the past few years have seen a rapid expansion in the issuance of sukuk securities across Asia and the Middle East. Although the global market at present remains relatively small, the issuance potential in the Gulf region is high. This market is forecast to grow as part of the systemic Middle East expansion in long-term conventional debt financing, combined with a drive to tap the deep pool of Islamic liquidity. Malaysia, where some 75% of corporate issuance has been Islamic in the past two years, provides a clear indication of future demand.

The Islamic finance market is also expanding in the area of investment banking, with significant growth in sharia-compliant transactions in project finance, corporate and structured finance, financial advisory, underwriting and syndication. Trade finance is another growth area not to be underestimated. Islamic trade financing techniques are readily embraced by many major western corporations in their business with the Muslim world and increasingly as a competitive advantage in their day-to-day activities.

Corporate treasury market operations comprise liquidity and yield management, and structured solutions. Corporates need to be aware of the parameters within which it is acceptable for a counterparty to operate, and feel comfortable with what is not a conventional financing arrangement. The need to marry secular tax, legal and accounting requirements with sharia adds an additional layer of complexity. Moving outside the realm of pure financial contracts, it is important to watch out for non-sharia-compliant elements in normal commercial contracts. An obvious example is provisions imposing interest charges on late payments, which would be unacceptable for a sharia-compliant counterparty. Alternative penalty arrangements need to be considered in such cases.

Innovation priorities

The Islamic finance industry has developed a comprehensive product offering across the entire range of investment banking, capital markets and retail segments of the business. Competition is fierce and the customer base is becoming more sophisticated and demanding. Innovation is now a major priority for shifting from sharia-compliant products to sharia-based solutions, with the introduction of new methods, ideas and products. Innovation has to take into account the multiple dimensions surrounding the world of Islamic finance, from technology and distribution channels to product development and the regulatory framework. The universe of assets that has been used to create sharia-compliant profit is still limited and there is great scope to expand it.

Private banking for high net worth individuals (HNWI) is attracting an increasing number of Muslim customers and represents one area in which innovation becomes a top priority for highly demanding customers. Global institutions with private banking arms, such as HSBC, have rolled out products specifically designed for this market segment, which is a growing segment of the world's wealthy individuals. The bank has a sharia-compliant offering focused on asset-backed leasing and liquidity management products.

One such product is the Alpha Currency Fund targeted at generating sharia-compatible returns for customers while providing them with liquidity. This is an unleveraged cash fund that generates returns by trading spot foreign exchange currencies on an intra-day basis. The returns of the fund are unrelated to other asset classes such as equities and the product has become popular with institutional and private banking clients.

The business model is another important area in which innovation is required to ensure sustainability. The window model in use up to now has enabled the growth of Islamic finance, however there is a longer term need for dedicated Islamic entities, along with a dedicated regulatory framework and licensing flexibility. More specialist firms will have to enter the field, including brokerages, Islamic investment banks, consultancy practices and venture capital firms. The current business models that dominate the Islamic finance business are aimed mainly at the educated and affluent population, in particular the huge segment of young Muslim professionals. But there is a tendency to neglect underprivileged customers, a problem that could be addressed by rolling out microfinance-type institutions to service microentrepreneurs and promote job creation.

The concentration of interest in developing investment and financing instruments for Islamic investors has resulted in a wealth of recent innovations. Aside from a surge in sukuk issues, there have been sharia-compliant hedge funds debuts, and prime brokerage and managed account units. Over the past year or so, sharia structuring techniques have become much more sophisticated and have opened up new asset classes and pay-offs which, in turn, have resulted in a notable jump in issuance. Banks have been working on equity-linked structured baskets, in which the stocks are specifically selected to be sharia-compliant. But they have also looked at developing some similar commodity-based products which allow for a lot more flexibility in product development.

As the Islamic market evolves, product innovation is spreading beyond the vanilla bond market. There have already been sharia-compliant real estate funds and secured equity funds, and this year saw the launch of the first sharia-compliant hedge funds in the US and UK. Bankers realise that investors who wish to comply with Islamic law are interested in investing in hedge funds because returns generated are a bond-plus type of return.

The successful roll-out and application of these products and services will depend to a large extent on the ability to provide dedicated technology platforms for Islamic finance institutions. At present, conventional banking systems with the introduction of selective modifications have been used to account and process Islamic transactions. Generally speaking, the outcome has resulted in a poor customer experience. This in turn has hit the credibility of sharia and raises the issue of inadequate disclosure. Implementation of appropriate accounting standards and practices is vital for a sound governance structure for Islamic financial institutions. Except for those that have adopted AAOIFI standards, transparency remains relatively poor.

So far only Bahrain, Sudan and Jordan have fully embraced these standards, though they are given some positive recognition elsewhere, most notably in Qatar and Saudi Arabia.

There is an urgent need to invest in dedicated and specialised accounting and processing systems to deal with Islamic transactions, and this includes technology platforms to facilitate sharia-based solutions. A similar situation exists in Islamic distribution channels, which are essentially replicas of conventional channels and will have to evolve to meet the requirements of Islamic customers.

Product development

A sharia-based mindset is critical to achieve product innovation. This applies, for instance, to the field of securitisation in order to create instruments with predictable yields and a full spectrum of maturities. A lot of sukuk securitisations have been put into place, but these have so far been relatively basic. Also included in this category are venture capital and private equity vehicles, as well as instruments to enable a ‘real economy’ play. There is a need to develop hedging instruments for risk management, for instance by using risk pooling concepts of takaful (insurance). Other innovative concepts being developed are savings schemes using infrastructure projects as sources of investment return, and substitute commodity-based financing products with specific asset-backed or linked products.

So far the market has been working on equity-linked structured baskets, in which the stocks are specifically selected to be sharia-compliant. Structuring techniques are now sufficiently developed to be applied to develop almost any sort of product. The greatest intangible to enable Islamic finance and build its future is the ability to create a qualified and dedicated workforce to deal with the complex issues of Islamic finance. The Islamic finance sector may be booming but it is struggling to establish a common education standard as qualifications are developed to meet the growing demand for specialised professionals. Regional differences in how banks prepare and communicate accounts as well as how they interpret sharia are confusing investors and holding back the sector’s rate of growth.

Accounting standardisation

Islamic banks in the UK differ in their accounting operations from banks in Bahrain, which in turn differ from banks in Malaysia and Indonesia. Standardisation in Islamic finance is necessary to avoid fragmentation and to ultimately create a new asset class that can fully compete with conventional finance. The UK, which wants London to become the global centre of Islamic finance, has introduced an Islamic Finance Qualification (IFQ), which it hopes will become a global benchmark. Global giants such as HSBC, along with the International Monetary Fund and the Financial Services Authority, have already enrolled their employees onto the course.

In Malaysia, a different qualification is being offered by the International Centre for Education in Islamic Finance. The AAOIFI, as one of the Islamic finance industry's main standard-setting organisations, has issued several standards on Islamic accounting, auditing, governance, ethics and sharia. The AAOIFI offers its own qualification and has launched its Certified Islamic Public Accounting (CIPA) programme, which is now being used by accounting organisations and central banks, including the Central Bank of Egypt, KPMG and Deloitte & Touche. With different countries offering different Islamic finance qualifications the next stage will be to standardise professional qualifications on a global level.

The academic world needs to get involved in helping to promote the growth and professionalism of Islamic finance. Input is required from institutions of higher learning to formulate a visionary framework. This will help to develop a change in mindset from sharia-compliant to sharia-driven products and services. A crucial element of this process involves a proactive engagement of regulators, practitioners and sharia scholars to set a common agenda aimed at achieving these goals.

From emergence to innovation

Islamic finance has established solid roots in the Gulf states, Malaysia and Indonesia and is set for a roll-out to the world's 1.6 billion Muslims, with all the challenges that this entails. Joe DiVanna explains.

On a scale of market maturity where one equals embryonic and 10 is a mature economy in steep decline, the Islamic finance industry in 2007 achieved a score of 2.4 (in the early stages of the innovation phase), according to Maris Strategies. In our estimate, the global benchmark for the Islamic finance industry is $500.5bn, which is not a complete number as almost 45% of the institutions claiming to provide some type of sharia-based financial services have not reported figures on their Islamic operations.

Compiled from 47 nations where institutions have announced that they offer sharia-compliant services, the data suggest the market is moving from a late-stage embryonic state to an industry in the early stages of innovation. The review of financial services offerings in 2006-07 shows that most sharia-compliant products simply mimic the offering of conventional institutions. There are two clear reasons for this: customers needed to be able to compare and contrast sharia-based services with their conventional banking counterparts and the technological infrastructure of banking software was based solely on conventional banking models.

During 2007, these two factors have begun a radical transformation as sharia-compliant financial institutions have started to realign their value propositions to customers. In markets where generations of Muslims have been banking with conventional institutions, simply providing access to sharia-based services means that an initial wave of migration has been under way.

However, Muslims with sophisticated banking needs have compared the fees and returns of sharia-based services and found in many markets that there is a high cost for their faith. In several western nations, Muslim customers have opted to stay with conventional banking and reconcile any interest payments or receipts with an equal amount in zakat (tithes), and simply wait for the premium for sharia service to fall and match their current banking costs. In many other markets, Muslims simply need access to sharia services. Perhaps the next big wave of Islamic banking expansion will be to the vast numbers of unbanked people across the globe.
The second change relates to sharia-compliant products themselves, as incumbent technological infrastructures (mostly software) are rapidly changing to meet the needs of a growing base of sharia-inspired products. A number of banks are now working with software vendors to redevelop or certify that their products provide adequate documentation and audit capability to meet the requirements set by sharia boards.

Several more adventurous banks have set out on their own to rewrite or create software that enables them to bring sharia-compliant products to the market.

Conversion and compliance

Compliance to sharia principles by financial institutions varies from country to country as the need to interoperate with their non-sharia-compliant counterparts requires, at times, a broad interpretation of the boundaries of how sharia principles are applied to the world of financial instruments that are becoming more complex.

At a macroeconomic level, sharia-compliant institutions operate in three distinct economic environments:

- Islamic nations that strive to maintain purely sharia-based banking systems.
- Islamic nations that have mixed-mode financial systems.
- Non-Muslim nations that have established some level of regulation that addresses sharia-based banking.

Nations such as Saudi Arabia, Iran and Pakistan have a clear agenda by which they are realigning their regulatory structures to be in stricter compliance to more conservative interpretations of sharia principles.

Misalignment and growth

At present, access to sharia-based products and services are concentrated in the six Gulf Cooperation Council (GCC) states, Malaysia and Indonesia. Thus the vast majority of Muslims worldwide are currently not served by Islamic finance. This mismatch of service providers to potential customers is a normal progression for an industry in its early development. This also creates the next growth opportunity for banks to expand into other Muslim markets. Within unserved markets, the opportunity for banks to grow their customer base falls within three distinct market segments: Muslim high net-worth individuals (HNWIs) and families; Muslims with conventional banking relationships; and the massive unbanked parts of society. Once again, this misalignment of banking services to populations that need access to financing is a good indicator to the overall maturity of the industry which is still in its adolescence.

Transparency and standards

In 1974, the Union of Arab Banks identified the need to create some level of standards across Arab banks. Today, organisations such the Auditing & Accounting Organisation of Islamic Financial Institutions (AAOIFI) and several central banks are working toward resolving numerous issues on transparency and the need to have standards across the industry.

That said, the lack of specific reporting of sharia-compliant holdings and activities separated from non-sharia holdings on balance sheets and income statements makes a total assessment of the market problematic. The central banks of Iran, Saudi Arabia and Pakistan have initiated steps to bring greater clarity in their countries on reporting sharia-finance activities; however, as an industry, there is much to be done to improve the quality of reporting. On an ironic note, despite calls for transparency in the banking sector, all the central banks contacted in the Americas, Europe and the rest of the world either declined to furnish data or were unable to calculate sharia compliancy within their nations. As an exception, the State Bank of Pakistan provided a complete listing of all the data requested for our research.

Participation by conventional banks

Universally conventional banks with sharia-compliant activities have not published figures that specifically reflect their overall performance in Islamic finance. They argue that reporting specific activities or a summary of activities resulting in balance sheet and income statement entries of sharia assets, sharia-generated profits or Tier 1 and 2 capital is technically not a requirement by regulators. Almost all conventional financial institutions contacted for this research elected not to disclose their sharia numbers, providing explanations such as a lack of available accounting mechanisms to separate sharia-compliant activities from non-compliant activities. Other institutions explained that the volume of their sharia activities is a “competitive secret”.

Globally, 524 institutions indicated that they were engaged in some form of sharia-compliant activities, with 317 institutions (60%) reporting financial activities; of the reporting group only 221 institutions (42%) reported sharia-compliant assets and activities separately. One factor to consider is that the lack of separate reporting is also adding to confusion on the part of customers who cannot readily assess whether their bank’s activities are 100% halal (permissable).

Facilitation of transnational commerce

One observation made in the review of individual institutional activities is the growing importance of facilitating transnational commerce and migrant remittances. Facilitating the movement of funds between nations for Muslim businesses is a big opportunity for Islamic banks. Although the volume of transnational commerce between Muslim nations is low, banks are reporting a steady rise in the past five years. Migrant remittances are increasingly gaining the attention of banks worldwide as financial institutions become more aware of the volumes of funds being transferred through regional informal money transfer networks.

In addition, capturing remittance traffic and moving these transactions into the formal banking systems is doubly important to Islamic banks because remittances represent large pools of untapped capital that is non-regulated, non-taxed and untraceable.

Innovation and market differentiation

As the fee structure of Islamic banking comes under greater scrutiny by customers, the need for innovation will be paramount for Islamic banks. The impact of innovation on the value proposition for Islamic banking is important not only in the sense that new products will need to be crafted to hide or justify higher operating costs; innovation will be needed to reduce operating costs, make reporting more transparent and enable customers to perform more self-service transactions under a set of automated sharia-compliant products.

Innovation is emerging as the differentiating factor in an Islamic bank's value proposition. The analysis revealed banks innovating along three distinct fronts: to reduce costs by streamlining operations, developing more engaging customer experiences to encourage emotional attachments to a bank's brand/services, and the development of new financial instruments targeted solely at the needs of commercial ventures in Muslim nations.

Islamic banks looking for expansion into unbanked populations are realising that technology is the key to viable access for customers, many of which will only use channels such as mobile phones or use intelligent ATMs. Thus for sharia-compliant banks, innovation is synonymous with leveraging the power of technology, which is reflected in the increasing volumes of banking technology sales throughout the Muslim world.

New generation must set sights on profit and returns

How profitable are Islamic financial institutions? With Islamic instruments and different reporting standards in some cases, direct comparisons with traditional western interest-bearing instruments have often been difficult to make. But as Islamic finance moves into the second stage of its modern growth, customers are keen not only on the Islamic nature of the financial instruments offered, but also on the returns offered and how they compare with other financial products. The challenge for the new generation of Islamic institutions is in providing not just sharia-compliant products but also competitive returns. Given the risk-sharing aspect of Islamic finance, in which the institution participates in the risk of the instrument along with the customer, exact returns are not as clearly defined as they are with so-called western products. This aspect, combined with the relative lack of financial disclosure in the industry, has made comparisons more difficult.

However, competitive pressures are expected to drive the industry into more openness. In its first Top 500 Islamic Financial Institutions listing, based on the information available, The Banker has attempted to provide a ranking of the most profitable Islamic institutions on the basis of return on assets (RoA) and pre-tax profits. Sudan's El Nilein Insurance Company topped the profitability rankings with 37.3%, followed by United Arab Emirates finance house Tamweel with 35.1% and Kuwait's International Leasing and Investment Company with 33.5%. These RoA figures compare very favourably with the average RoA figure of The Banker's Top 1000 World Banks (1.06%). In the Top 25 below, insurance companies account for 10 of the leading players and the top banks are Bahrain's Unicorn Investment Bank (13.6%) and Saudi Arabia's Bank Al Jazira (13.2%) in 11th and 13th places respectively.

In pure pre-tax profits terms, the leading players in the table below contain many institutions that offer sharia-compliant products through so-called Islamic 'windows' but which have provided no detailed figures for those sharia-compliant assets (SCAs). In this way, BNP Paribas heads the listing for the highest profits of an institution offering SCAs but, like all of the 13 institutions ranked 222 in our Top 25 listing, it did not provide any details of its SCAs. The real positions in terms of SCAs are not clear. Saudi Arabia's Al Rajhi Bank (in fifth place) is the most profitable institution with 100% SCAs.

TABLE: TOP 25 ISLAMIC INSTITUTIONS BY ROA

TOP 25 ISLAMIC INSTITUTIONS BY ROA

Ranking by RoA	Top 500	Institution	Country	Return on assets (%)
1	215	El Nilein Insurance Co.	Sudan	37.27%
2	75	Tamweel	UAE	35.10%
3	117	International Leasing and Investment Co.	Kuwait	33.51%
4	185	Karafarin Insurance Co	Iran	21.03%
5	190	Islamic Insurance Company	Sudan	20.91%
6	97	First Investment Company	Kuwait	20.58%
7	198	The United Insurance Co. (Sudan)	Sudan	18.72%
8	169	First Takaful Insurance Co	Kuwait	16.90%
9	131	Al Madina for Finance and Investment Co.	Kuwait	16.52%
10	130	Al Safat Investment Company	Kuwait	15.49%
11	112	Unicorn Investment Bank BSC	Bahrain	13.62%
12	65	AREF Investment Group	Kuwait	13.24%
13	27	Bank Al Jazira	Saudi Arabia	13.21%
14	115	Bank Perusahaan Kecil & Sederhana Malaysia Bd (SME Bank)	Malaysia	13.19%
15	148	Sheikan Insurance & Reinsurance Co.	Sudan	13.06%
16	63	National Investment Trust, Karachi	Pakistan	12.78%
17	183	Arabia ACE Insurance Company	Bahrain	12.59%
18	210	Arabia ACE Insurance Company	Saudi Arabia	12.59%
19	222	KUWAIT FINANCIAL CENTRE (Markaz)	Kuwait	12.01%
20	222	Al Ain Ahlia Insurance Co	UAE	11.93%
21	119	International Investment Group	Kuwait	11.53%
22	34	Ithmaar Bank BSC	Bahrain	10.82%
23	114	Sokouk Holding Company	Kuwait	10.60%
24	211	Red Sea Insurance Company	Sudan	9.93%
25	121	Khaleeji Commercial Bank	Bahrain	9.56%

Source: **The Banker**

TABLE: TOP 25 ISLAMIC INSTITUTIONS BY PROFITS

TOP 25 ISLAMIC INSTITUTIONS BY PROFITS

Ranking by RoA	Top 500	Institution	Country	Pre-tax profits
1	222	BNP Paribas	France	13,920.70
2	222	Deutsche Bank AG	Germany	10,700.63
3	222	Société Générale	France	10,638.73
4	222	Credit Suisse	Switzerland	2,599.87
5	4	Al Rajhi Bank	Saudi Arabia	1,949.77
6	15	National Commercial Bank, Jeddah	Saudi Arabia	1,675.29
7	222	ABSA Group	South Africa	1,638.02
8	222	OCBC BANK	Singapore	1,539.20
9	20	Samba Financial Group	Saudi Arabia	1,391.29
10	19	Maybank	Malaysia	973.30
11	222	Lloyds TSB	UK	966.36
12	222	National Bank of Kuwait	Kuwait	877.80
13	22	Saudi British Bank	Saudi Arabia	811.82
14	18	Banque Saudi Fransi	Saudi Arabia	802.92
15	23	Riyad Bank	Saudi Arabia	776.65
16	36	Public Bank Berhad	Malaysia	690.96
17	222	Arab National Bank	Saudi Arabia	668.82
18	7	Kuwait Finance House, Safat	Kuwait	668.29
19	222	PT Bank Rakyat Indonesia	Indonesia	654.85
20	222	National Bank of Abu Dhabi	UAE	587.32
21	1	Bank Melli Iran, Tehran	Iran	585.58
22	222	Abu Dhabi Commerical Bank	UAE	584.67
23	222	Qatar National Bank (Al Watani)	Qatar	550.70
24	98	Saudi Investment Bank	Saudi Arabia	535.72
25	27	Bank Al Jazira	Saudi Arabia	527.0917

Source: **The Banker**

Worldwide partnership

Long-term viability and sustainability will come from increased interoperation between sharia-compliant financial institutions throughout the world, says Joe DiVanna.

Perhaps the biggest questions facing the Islamic finance industry are: can the ever-increasing rate of growth be sustained? And will all sharia-compliant institutions be viable?

Like the complex nature of Islamic finance, the answer to these questions is equally complex, as national economies fluctuate with numerous variables beyond the controls of the banking sector. However, one thing is clear: barring any significant downturn in the Middle East markets, strong growth in the industry is likely to continue. At the microeconomic level, the viability of individual institutions is also unknown as the competitive boundaries are also in the process of redefinition. The market for Islamic banking has begun to consolidate in several markets as key urban centres reach a saturation point, as seen by the recent merger between Emirates Bank and the National Bank of Dubai.

However, in most regions the demand for sharia-compliant services is still far below any saturation point. In short, the lack of access is driving the demand for sharia-compliant services, which will remain high as the overall access to services increases in communities where services have been unavailable.

The second value driver for sharia-compliant services is the presence of profit-seeking investors, as seen in the oversubscription of sukuks (bonds) throughout the Middle East. In spite of the popularity of sukuks, conservative sharia scholars have argued that this offering may not be effective in avoiding interest-like activities because the nature of sukuks requires payment for the time-value of money. As sukuks offer investors a fixed return on their investments, they also fall into contention with some sharia scholars because they are, in many cases, independent of risks in a particular venture and interpreted by some as not equally sharing risk and return, which is another fundamental tenant of sharia principles. That said, in many mixed-mode economies, asset-backed sukuks are progressively more attractive to worldwide Muslim and non-Muslim investors.

To sustain the overall growth in the Islamic finance market in the long-term, regional co-dependency between national economies will increase the ability for regional businesses to conduct activities across borders, with a minimum of encumbrances. Central banks and political figures in various Islamic regions will need to achieve increasing levels of regulatory collaboration, which will be the key to regional competitiveness. Creating a level playing field for Islamic finance is the key to sustainable growth whereby economic activity of nations with a dominant Muslim populations must seamlessly interact on par with the economic engines of the US, Europe and China. Facilitating the next level of growth in the industry will require Islamic nations to begin transnational economic and monetary collaboration on a scale without precedent. The starting point for this type of transnational collaboration may indeed be the Gulf Cooperation Council (GCC) monetary union slated for 2010.

Three future scenarios

The challenge for institutions offering sharia-compliant services is that the Islamic finance industry is poised to grow along three distinctly different competitive fronts: growth by fundamentals, growth by innovation, and growth by market redefinition.

Growth by fundamentals will be achieved by providing primary banking services to the vast numbers of unbanked Muslims and non-Muslims worldwide. Banks in saturated markets are turning to other geographies for their growth strategies by introducing services into new markets or establishing collaborations with local banks. In Saudi Arabia, HSBC and SABB have partnered to bring co-branded wealth management products to conventional banking customers; it is only a matter of time before this type of collaboration occurs across sharia-compliant competitors.

Growth by innovation is perhaps the most immediate challenge for Islamic banks and their conventional counterparts. Currently, Islamic banks offer sharia-compliant services that simply replicate their conventional counterparts. True market innovation must occur at multiple levels within the value propositions of Islamic banks across the entire spectrum of their activities. In the short-term, banks need to become best-in-class for services with ultra-efficient cost structures to compete against larger institutions that have the advantage of economies of scale. Simultaneously, Islamic banks must create new products and develop services that engage customers in a meaningful value-added dialogue that informs, educates and advises on the relativity of a customer's actions to their financial goals within a framework of sharia compliance. In the longer term, innovation must produce new services designed specifically to facilitate the lifestyles of retail customers and the commercial activities of Muslim businesses.

Growth by redefining the market is in a very early stage, as issues such as GCC monetary union and other macroeconomic factors are converging to change the competitive landscape for sharia services in the Middle East and beyond. One scenario discussed with senior bankers, regulators and academics is the concept of regional co-opetition in the creation of a single regional market for sharia-compliant financial centres specialising on a specific aspect of Islamic finance.

The financial acumen of the financial centres in Bahrain, Kuwait, Malaysia, Qatar, Saudi Arabia and the UAE combined into one comprehensive suite of sharia-compliant services electronically linked and regulated by a basic framework of standards and collaborative monetary policies could theoretically become a contender for global banking services on a par with New York, London and Hong Kong.

In the case of long-term competitive positioning on global markets, a sharia-compliant co-opetition (not to be confused with a cartel) is a synergistic interdependence between competitors operating within Muslim nations. Fundamentally, it is a co-operative system of economic value creation based on a mutual interdependence whereby competitors in sharia-based services are concentrated into ultra-efficient electronic markets that share infrastructure resources such as clearing, settlement and a host of support services. The shared infrastructure provides a platform that facilitates or enhances the products and services offered throughout the market without compromising an individual institution's direct perceived value to customers.

Dynamics of the market

Interviews with senior bankers, regulators, analysts and academics indicate a growing realisation that the economics of the Middle East are changing towards a higher degree of interdependence across financial markets and an increased sense of economic unity when contrasted with western financial markets. Market demand for sharia-compliant services, represented by a 29.9% growth rate between 2006 and 2007, is growing in each of the 47 nations reporting sharia-compliant activities. The annual reports of financial institutions reflect a growing optimism on the state of the economies across Muslim nations which can be validated by the increase in spending by financial institutions in their pursuit of providing a greater range of sharia-compliant services.

Initiatives such as the GCC monetary union or the fundamentals of Islamic monetary union as expressed by Pakistan's prime minister, Shaukat Aziz, are increasingly being discussed and debated throughout the Muslim financial community. The general consensus is that the technology and know-how required for such market redefining actions exist today and are within the financial reach of most participating nations. The missing ingredient is an overarching political will to reinvent the dynamics of the markets on a truly global scale. This is not surprising due to the relative immaturity of the Islamic finance industry and, as several academics have argued, change on this scale is perhaps too early given the industry's overall development.

Numerous institutions interviewed expressed concern over the forthcoming shortage of experienced sharia scholars. Because sharia is not a set of codified laws, but rather a set of interpretations based on the Koran, the Sunnah, the judgement of scholars and consensus agreement, it follows that rulings are affected by personal beliefs and cultural influences. The current sharia scholars have gained their experience during the past 30 years of the industry's growth and now with the rapid expansion of sharia-compliant services these scholars are in high demand and often spread too thin to accommodate demand. Islamic banks are concerned with where the next generation of scholars will come from and the quality of their experience.

When worlds collide

In the final analysis of the Islamic finance market, long-term viability and sustainability will come from increased interoperation between sharia-compliant financial institutions throughout the world. Initiatives such as monetary unions, trade collaboration and economic policy synchronisation will influence the Islamic finance industry in three ways: increased efficiency, increased capacity, and increased access for customers worldwide. The technical mechanisms for monetary and currency union exist today; they are well known and are understood by experts in the Gulf and Europe. However, the synchronisation of political agendas, fiscal policies, economic objectives and monetary goals requires an extreme amount of political will power.

Economic co-ordination and strict budgetary discipline by each member state is essential to prevent asymmetric shocks; therefore, discussion and planning may take longer to achieve the level of consensus required to craft meaningful policy guidelines. This level of regulatory discipline will provide the Islamic finance industry with increasing levels of stability adding to the overall competitiveness of sharia-compliant institutions in the world market.

However, analysts, academics and the media have been speculating on the amount of progress towards the achievement of initiatives such as the GCC monetary union with guarded scepticism. Nevertheless, one must remember that this is the Middle East, not Wall Street; building consensus is an art form which takes time and patience, and once achieved things move very quickly. There is an old Arab proverb that says: “A tent cannot be put up with one peg.”

Joe DiVanna is the author of numerous books on banking including Understanding Islamic Banking: The Value Proposition that Transcends Cultures, and is the managing director of Maris Strategies, a Cambridge-based strategy think tank for financial services and applied economics.

METHODOLOGY

The methodology begins with compiling a list of the world’s financial institutions offering some type of sharia-compliant financial services from various sources. Central banks and government financial supervisory agencies have been the initial points to identify those institutions. For the countries where the central banks and government agencies do not categorise the Islamic financial institutions separately, we were able to find institutions providing sharia-compliant financial services through a number of associations that provide accounting and auditing services for the Islamic financial institutions.

The next step was to collect all the possible data of the institutions on the list. Institutions that indicated they were sharia-compliant financial services, from basic bank accounts to insurance products, were contacted and asked for their latest financial data. Many responded with annual reports and quarterly statements. An equal number did not and their result are reflected on the listing as not available (n/a), however, we have elected to include them on this list to illustrate the diversity of the market. Wherever possible, the collected data has been verified from multiple sources.

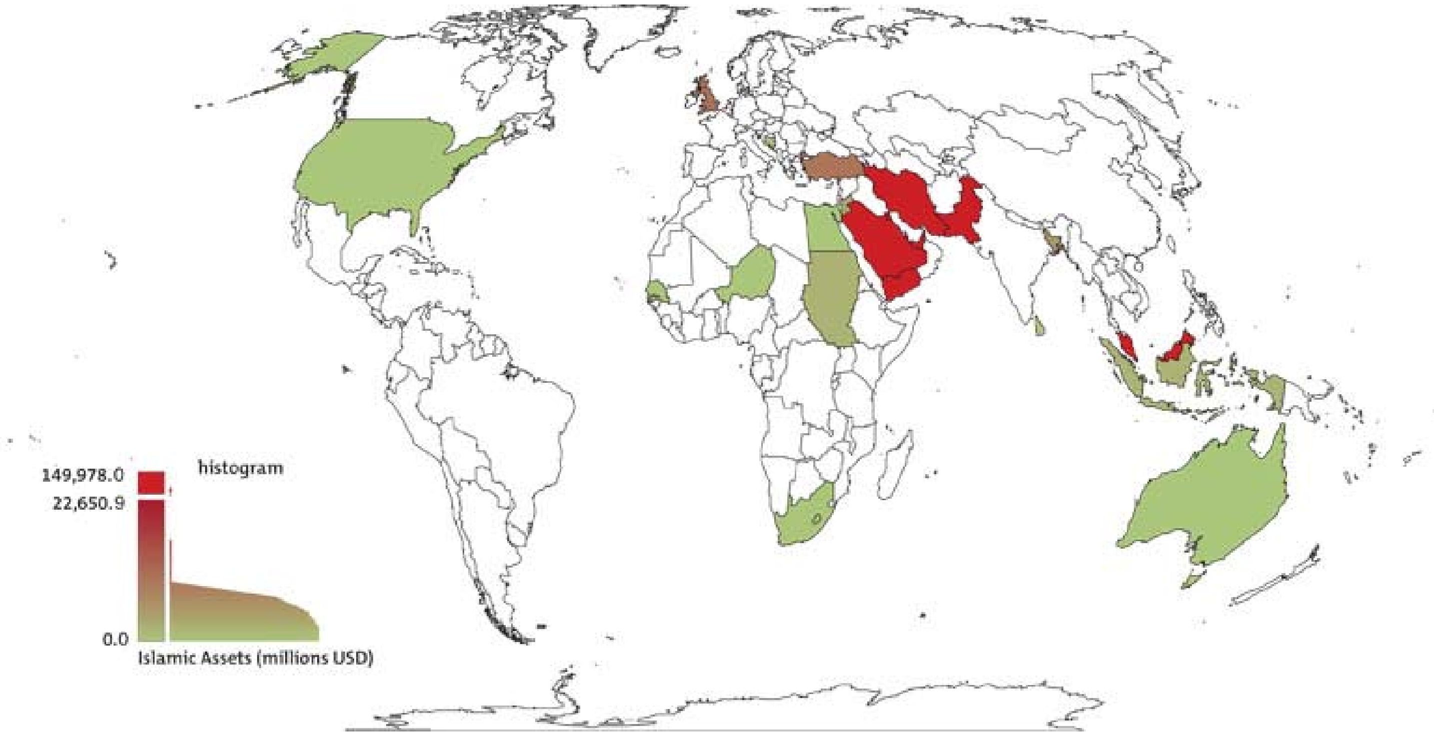
Making comparisons

One inherent problem with developing a topology of an emerging industry is the lack of a formalised structure that will allow comparing the underlying value of institutions and their relative contribution to the industry. Financial institutions such as commercial banks and other institutions of similar structure provide basic mechanisms for comparisons, such as assets, profits and paid-up capital. Institutions such as investment banks, insurance companies and other organisations that are engaged in financial services present a problem for inclusion in an industry benchmark because the use of a measurement such as sharia assets does not accurately reflect the business activity or the overall contribution they make to the industry as a whole. Therefore, we acknowledge that including these types of institutions with their full-service banking counterparts is akin to comparing apples to oranges.

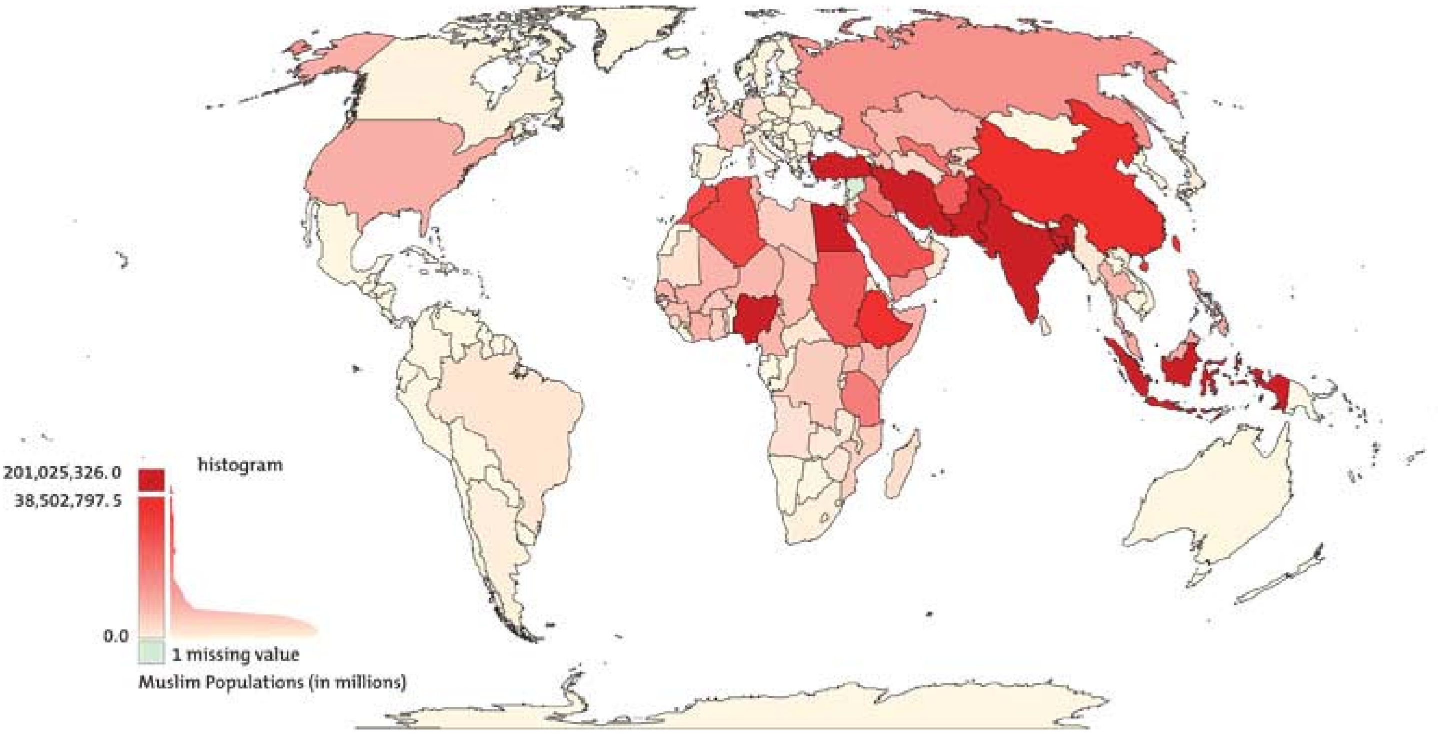
However, at this early stage of the industry, for codification purposes they are included (perhaps unfairly represented in value) to illustrate the totality and variety of the market, simply for the purpose of depicting the entire market – they may be apples and oranges but they are also both fruit. Our intent in the forthcoming year is to work with investment banks and insurance companies to develop a better descriptive measure to reflect the role they play and value they generate in the market.

As we developed the benchmark, it became clear that there is a need for greater clarity in quantitative and qualitative reporting of sharia activities by institutions, and that this information should be supplied to central banks for national summation. To improve the quality of data for next year’s listing we will be contacting central banks to propose a more uniformed reporting schema and a higher degree of clarity in institutional classification.

MAP: ISLAMIC ASSETS



MAP: MUSLIM POPULATION



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