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ISLAMIC BANKS AND THEIR ROLE IN DEVELOPMENT PROCESS 2010-2014

Euromoney Conference –Kuwait April 2011

Financing Development – Development Financing

Agenda

1- Benefits of Islamic Finance

2 - Precedents of Islamic Finance in Financing Development

3 - Aspects of Kuwait Development Plan

4 - The Role of Islamic Banks in Financing Development in Kuwait

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1- Benefits of Islamic Finance

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- Principle of **justice** is an essential requirement for all kinds of Islamic financing; the financier and the beneficiary **share** the actual profit / loss.
- The financing of Islamic banks is restricted to **useful goods** and **services** and **refrain from** financing other **harmful ones** reducing the social and economic cost of such harmful products and activities.
- The **ethical and moral consideration** of Islamic banks **cannot be detached** and their **behavior** should be consistent with the moral and ethical standards laid down by the Islamic Shari'ah.

1- Benefits of Islamic Finance

- The Islamic banking sector is experiencing consistent annual growth of 10-15%.
- There are more than **300** Islamic banks operating in more than **50** countries, and more than **500** Sharia-compliant mutual investment funds. The assets of Islamic banks are estimated at **$800-1000bn**.
- Some international as well as local institutions have stepped into this multi-billion dollar industry by establishing their **Islamic units**; HSBC (HSBC Amanah), Citi Bank (Citi Islamic) and Standard Chartered.
- **Islamic Bank of Britain** is the UK's first **FSA** (Financial Services Authority) approved Islamic Retail bank in 2004.

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1- Benefits of Islamic Finance

Resilience to adverse economic & financial crisis

- Islamic banks were **less affected by the aftermath & repercussions** of the **global financial meltdown** which shook the economy in many countries around the world, causing a significant number of investment banks to go **bankrupt and out of business**. (Lehman, AIG, RBS…etc)

1- Benefits of Islamic Finance

Resilience to adverse economic & financial crisis

- A new **IMF study** compares the performance of Islamic banks and conventional banks during the recent financial crisis, and found that Islamic banks, on average, showed **stronger resilience during the global financial crisis**.

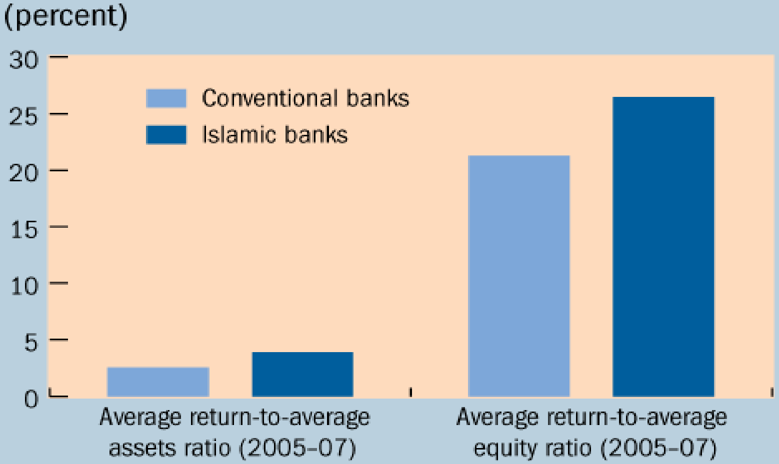
1- Benefits of Islamic Finance

Resilience to adverse economic & financial crisis

Chart 1

Before the crisis

Islamic banks were more profitable than their conventional peers in the runup to the crisis.

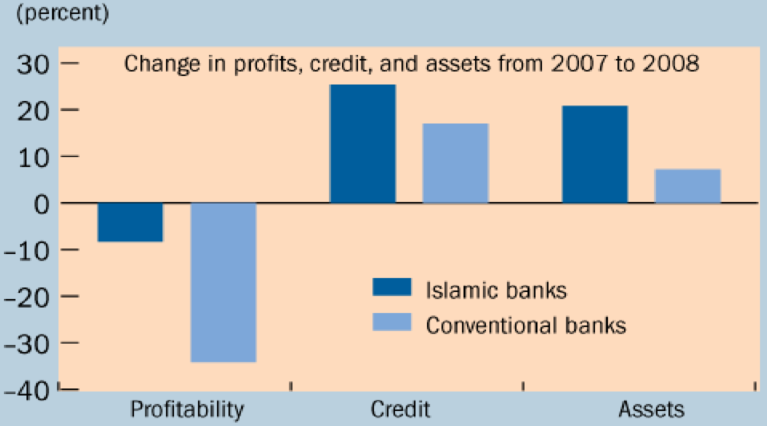


Sources: IMF staff estimates and calculations.

Chart 2

Initial crisis effect

Islamic banks saw only a minor impact on profitability in the early stages of the crisis, while credit and asset growth remained strong.



Sources: IMF staff estimates and calculations.

Hasan, Maher | Dridi, Jemma IMF
Published: September 1, 2010

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Islamic banks "Challenges revealed"
What is Needed?

While the global crisis gave Islamic banks an opportunity to prove their resilience, it also brought to light some **important challenges**. Going forward, the industry will need to **focus on the following priorities:**

1. Building a well-functioning **infrastructure for liquidity management;**
2. Ensuring that the **supervisory and legal infrastructure**, **remain relevant** in the rapidly changing Islamic financial landscape.

Islamic banks "Challenges revealed"
What is Needed?

3. Aligning **reform** efforts with the **global** financial regulatory **reform agenda**; and **harmonizing regulations and products** to foster the efficient and sustainable growth of the Islamic banking industry.

4. To address these challenges, Islamic **banks and supervisors** will have to **work together** to develop the needed **human capital**, since expertise in Islamic finance has not kept pace with the industry's growth

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2 - Precedents of Islamic Finance in Financing Development

2 - Precedents of Islamic Finance in Financing development

Financing the Development Sukuk based approach

- Malaysia began offering Islamic services almost 30 years ago and a sale of Sukuk, or debt that complies with Islam's ban on interest, would enhance Malaysia's position as the world's biggest market for the debt.

  Prime Minister Najib Razak, Bloomberg, Apr 1, 2011

- "All huge infrastructure projects in Malaysia have always been **funded by Islamic bonds**, because Islamic bonds would attract a **wider investor base** and therefore increase the opportunity for any issuance to raise a larger pool of funding."

  Bloomberg, Apr 1, 2011

Sukuk based approach

- Sales of Islamic Sukuk (bonds) in Malaysia totaled **$94 billion** as of last year and accounted for **66 percent of the amount outstanding globally.**

Central bank of Malaysia, 2010 annual report.

3 - Aspects of Kuwait Development Plan

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Kuwait Development Plan - 2010/2014 **Estimated at >** US$120 billion

- The plan aims at :-
  - Decreasing the country's dependence on oil, but also to include investment on raising oil and natural gas production.
  - Turning Kuwait into a **regional trade and financial hub** through sustaining economic development, economic diversification and GDP growth.
- Private sector will be involved in such projects through different schemes including **BOT / BOOT & PPP**.
- Consequently, banking sector will have the opportunity to provide **credit lines / finances** for such projects
- This will have its direct positive impact hand in hand with the **expansionary monetary policy to increase liquidity**.

3 - Aspects of Kuwait Development Plan

Kuwait Development Plan - 2010/2014 **Estimated at >** US$120 billion

- The plan was approved with estimated **KD37bn (US$127bn)** of spending focusing on both oil and non oil economic sectors.

- The plan will depend on **both pillars** of the Kuwaiti economy i.e. **government capital expenditure** hand in hand with increased **private sector participation**.

3 - Aspects of Kuwait Development Plan

The plan includes broad spectrum of Mega Projects

- Additional spending on
  - New cities
  - Infrastructure
  - Services; particularly health and education
- 25km causeway
- A major container harbor
- Around KD21-25bn of oil sector investments to raise production capacity and modernize current facilities.
- Railway and metro system

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3 - Aspects of Kuwait Development Plan

Kuwait Development by Economic sector

Distribution Per Sector	US$ Billion
Utilities	20-22
Services	8 – 9
Real Estate & Development	8 – 9
Contracting	9 -10
Oil & Gas	70 - 76

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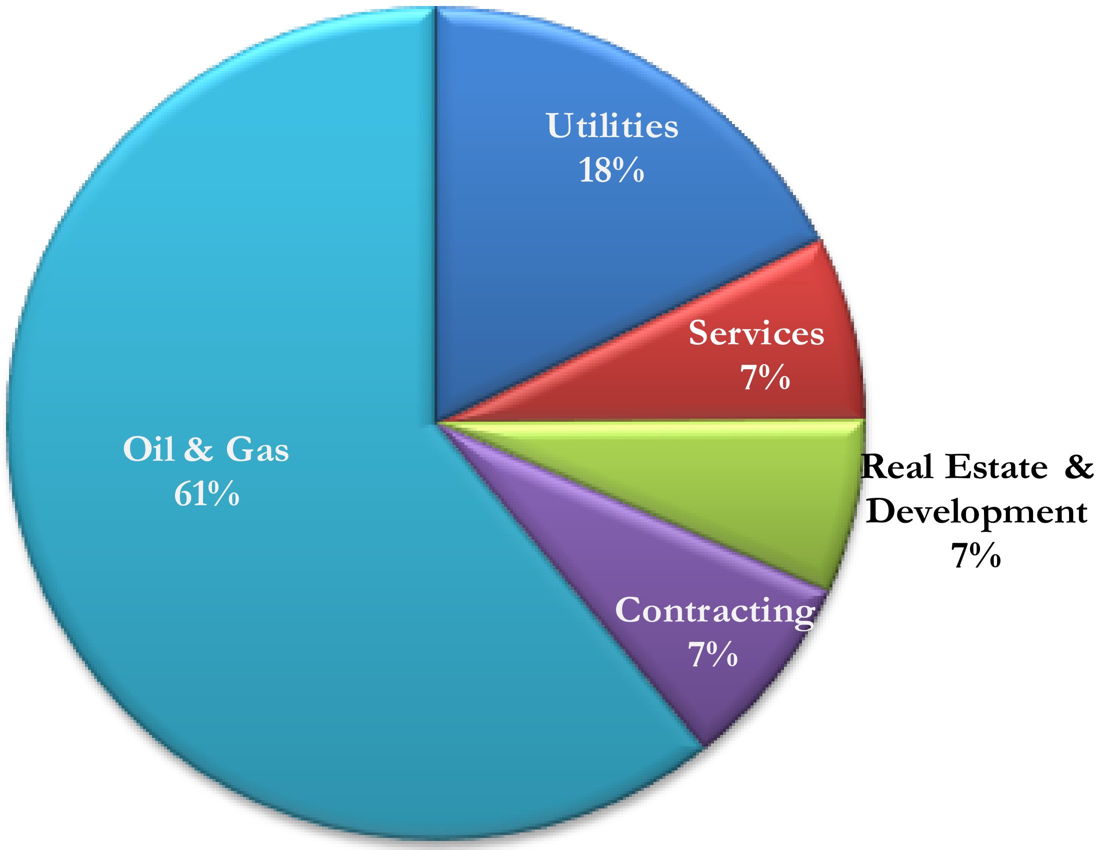
3 - Aspects of Kuwait Development Plan

Key sectors that will benefit from the Plan :-



3 - Aspects of Kuwait Development Plan

Financial Structure of Kuwait Development plan 2010-2014

- Establishing **publicly listed companies** according to the following **major guidelines** : -
- Not more than **24%** of the development companies shares is owned by the **government** and/or government related entities
- Not less than **26%** of the development companies shares, to be allocated via **public auction** for Kuwait Stock Exchange listed non-competing companies, or other companies approved by the cabinet
- **50%** of development companies shares to be sold **equally to all Kuwaiti citizens**

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4 - The Role of Islamic Banks in Financing Development in Kuwait

How can Islamic banks participate?

- During setup stage
- Post establishment of development companies

4 - The Role of Islamic Banks in Financing Development in Kuwait

How can Islamic banks participate during setup stage?

- Financing IPOs to **institutional investors** (KSE listed companies) and others as per regulatory authorities representing not less than 26% of the said companies paid-in capital
- Financing IPOs via sharia'h compliant funding to **Kuwaiti citizens** amounting to 50% of development companies paid-in capital

4 - The Role of Islamic Banks in Financing Development in Kuwait

How can Islamic banks participate
Post establishment of development companies?

Financing **development companies' target projects** through various **sharia'h compliant finances** to the following :-

(a) Main contractors

(b) Sub-contractors,

(c) Equipment and building materials suppliers

(d) Other service providers

4 - The Role of Islamic Banks in Financing Development in Kuwait

Major Tools & Possible Vehicles

- Islamic Sukuk issues.
- Murabaha financing
- Ijara “Lease to own”
- Istista’a
- Musharaka

All of the above Islamic tools are available for stakeholders including but not limited to development companies, contractors, suppliers and service providers

4 - The Role of Islamic Banks in Financing Development in Kuwait

Financing the Development Sukuk based

Sukuk based approach

- Sukuk can be structured in different techniques.
  Sukuk constitute **partial ownership in** :
- Debt (Sukuk Murabaha),
- Asset (Sukuk Al Ijara),
- Project (Sukuk Al Istisna),
- Business (Sukuk Al Musharaka), or
- Investment (Sukuk Al Istithmar).

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4 - The Role of Islamic Banks in Financing Development in Kuwait

Financing the Development Sukuk based

- Most commonly applied Sukuk structures are:-
  - **listed on exchanges**, commonly Luxembourg Stock Exchange and London Stock Exchange in Europe, and
  - made **tradable** through conventional organizations like **Euroclear** or **Clearstream**.

4 - The Role of Islamic Banks in Financing Development in Kuwait

Could Islamic Banks Retail Customers participate in financing development?

YES

Open Ended Sukuk Funds financing KUWAIT ambitious development plan