Oman's Islamic banking performance in 2020 and outlook for 2021

Despite the industry still being in its infancy, Islamic banking entities in Oman by 2020 were expected to set another record of remarkable achievement over the next five years as one of the fastest-growing Islamic banking industries globally. This is because of full support from the regulatory authority through a strong regulatory framework designed by experts in the global Islamic banking and finance industry that covers all aspects of Islamic banking. DR MUHAMMAD IMAN SASTRA MIHAJAT delves further.

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However, the COVID-19 pandemic has forced the industry to slow down and to remake all the strategies that have been planned. This is because the impact of the COVID-19 outbreak has raised various challenges that need to be addressed collectively by the stakeholders of Islamic banking in order to maintain the sustainable growth of the industry. Nevertheless, Islamic banking entities are able to maintain and manage capital buffers and liquidity so that the growth for 2021 is expected to remain stable and adequate for the risks, although there would be continued asset-quality and profitability pressure for Islamic banks within the Sultanate.

Previously, Oman had two fully-fledged Islamic banks (Bank Nizwa and Alizz Islamic Bank) and six Islamic windows (Al Yusr Islamic Banking of Oman Arab Bank, Meethaq Islamic Banking of Bank Muscat, Muzn Islamic Banking of National Bank of Oman, Sohar Islamic Bank, Maisarah Islamic Bank of Bank Dhofar and Al Hilal Islamic Bank of Bank Al Ahli). However, after the successful merger between Oman Arab Bank and Alizz Islamic Banking that took place in October 2020, the number of Islamic windows in Oman has decreased to five windows while two fully-fledged Islamic banks remain.

Al Yusr Islamic Banking, the Islamic window of Oman Arab Bank, merged with Alizz Islamic Bank to become one of the largest Islamic banking entities within the Sultanate as a subsidiary of Oman Arab Bank, whereby Oman Arab Bank is the parent company of the newly merged company with the two entities having their own board of directors and management.

Table 1: Financial ratios of Islamic banks and windows in Oman (2016–20) (in millions OMR)

	December 2016	December 2017	December 2018	December 2019	September 2020
Total assets	3,100	3,570	4,300	4,900	5,000
Total deposits	2,170	2,970	3,260	3,600	3,700
Total financing	2,420	3,030	3,604	4,000	4,200
Islamic banking market share	10.3%	12.9%	13%	13.9%	14%

Source: CBO and modified from multiple sources

In the case Alizz Islamic Bank, it will have its own Shariah supervisory board that has no relationship with Oman Arab Bank.

Oman's Islamic banking performance in 2020

Even though Oman is still considered as being in its infancy and being the last country in the Middle East to introduce Islamic finance, Islamic banks in Oman showed much promise compared to its counterparts. As of the end of 2016, the total market share of Islamic banks in Oman reached 10.3% of the total banking assets in the Sultanate or equivalent to OMR3.1 billion (US$8.03 billion) with 71 branches throughout Oman. This is in comparison to some countries which needed 20–30 years in order to have an Islamic banking market share of 5–10% such as the UK and Indonesia.

2018 has become a golden year for Oman Islamic banking because in that year according to a Moody's Investors Service report, the industry was able to significantly improve its profitability to over OMR34 billion (US$88.08 billion) or an increase of around 76% over the previous year, in the process being recorded as the fastest-growing Islamic banking market in the GCC region with a growth rate of 14%. This tremendous accomplishment was achieved due to the hard work and determination of the Islamic banking stakeholders who worked hand in hand to make the impossible become the possible. However, Islamic banks should guard against complacency that would jeopardize the pace of the growth for the next five years.

Islamic banking entities were also able to generate assets totaling OMR4.3 billion (US$11.14 billion) representing around 13% of the banking assets in the Sultanate. Therefore, Moody's predicts that the GCC region will continue driving the growth of global Islamic finance assets for the next several years and remain robust with long-term prospects.

According to a bulletin issued by the Central Bank of Oman (CBO), at the end of 2019, Islamic banking entities were able to extend financing to OMR4 billion (US$10.36 billion), recording a growth of 11% over the previous year. Total deposits held by Islamic banking entities also recorded an increase of 10.3% to OMR3.6 billion (US$9.33 billion), while the total assets of Islamic banking entities increased to OMR4.9 billion (US$12.69 billion) as at the end of December 2019 and constituted about 13.9% of banking system assets (See Table 1). This rapid growth was partially due to learning from the experiences of other jurisdictions, although the CBO still does not allow Islamic banking entities to use the contracts of Bai Al Inah and Tawarruq in their products because these contracts are still being debated among some of the Islamic economists.

However, the year 2020 became the hardest time for the Islamic banking sector to maintain the growth, resulting in the slowest growth for the Islamic banking sector in Oman amid the COVID-19 outbreak. This was the first time in the history of Islamic banking in Oman where Islamic banking entities were only able to record a single-digit growth in the last seven years. At the end of September 2020, Islamic banking entities only provided financing of OMR4.3 billion, recording a growth of 6.7% over the previous year. Total deposits held with Islamic banks and windows increased by 7.7% to OMR3.7 billion (US$9.58 billion). The total assets of Islamic banking entities reached OMR5 billion (US$12.95 billion) and constituted about 14% of the national banking market share.

During 2020, Islamic banking entities played a pivotal role in supporting the government to strengthen economic activities within the Sultanate amid the pandemic, including the following:

1. Deferred monthly installments for a period of six to 12 months including short-term working capital facilities and term finance facilities (based on the contract of Wakalah, running Musharakah and balance fund transfer with an Ijarah sale and leaseback or Musharakah Mutanaqisah).
2. Provided a grace period or repayment holiday for SME customers for six to nine months (without increasing the profit even one single baisa/ceiling).
3. Provided an extension of the total number of installment repayments for term finance facilities based on the request of customers.
4. Provided rescheduling and restructuring of financing for customers having overdues (from 30 to 90 days) with Islamic banks as per the request.
5. Reduced existing fees relating to various banking services and abstained from introducing new ones during 2020.
6. Distributed the charity funds to charity organizations within the Sultanate.
7. Distributed a major percentage of corporate social responsibility funds to those affected by the pandemic and assisted the government in tackling and combating COVID-19 by contributing donations to an account designated by the Ministry of Health.
8. Contributed to the Job Security Fund initiated by the government of Oman through the issuance of Royal Decree No 82/2020 to support those who lost their jobs during the COVID-19 pandemic for different reasons.

Oman's Islamic banking outlook in 2021

The year 2020 was a very challenging time for the Islamic banking sector to maintain growth and Islamic banking entities saw a significant reduction in revenue and credit growth from double digits to single digits in the last seven years due to earnings being affected by the oil price drop and the COVID-19 outbreak. Since oil prices remain the top factor for the development of the Islamic banking and finance industry in the Sultanate, 2021 will be yet another interesting year for the industry with expectations of an upward direction in the growth of the Islamic banking and finance industry through the introduction of innovative product structures and instruments to attract more investors and customers.

Therefore, since the main issues in 2020 will remain in 2021, such as lower profit rates, lower business volumes and higher financing impairment charges as a result of lower oil prices and the COVID-19 pandemic, Islamic banking entities in the Sultanate will be focusing on preserving asset quality rather than business expansion. This is due to Islamic banks in Oman typically having a major proportion of exposure in real estate and since they are not able to charge late payment fees, they will see a greater effect on asset-quality indicators. That is why the pandemic will restrict the growth of Islamic banks this year to only a single digit if oil prices continue to dip below US$50 with real-estate corrections and low demand, as well a drop in the vital non-oil economic sectors such as tourism which will put pressure on Islamic banks' earnings.

Besides the severe challenges from the pandemic, there are also many current obstacles faced by Islamic banking entities in the Sultanate which remain, such as the lack of awareness about Islamic banking transactions and activities, a limited supply of qualified human capital in Islamic finance, insufficient liquidity instruments in the Islamic money market and the lack of Sukuk issuance and its availability in the secondary market. These challenges need to be addressed collectively by the stakeholders of Islamic banking in order to achieve the expected growth of the industry, especially in the area of Shariah matters where the major players need to incorporate Shariah governance into their good corporate governance framework.

As a suggestion, I believe it is the right time for the CBO to review the Islamic Banking

Regulatory Framework (IBRF), especially on Shariah governance, by strengthening the position of the Internal Shariah Department within Islamic banking entities to the annual general meeting level in a fully-fledged Islamic bank, and that of senior executive management in Islamic windows. In addition to that, the CBO should establish a Shariah unit reporting to the High Sharia Supervisory Authority in order to facilitate and align the communication between this unit and the Internal Shariah Department within Islamic banking entities.

And finally, in 2021, Islamic banks will be able to evolve with a new business model, transform the processes, adapt the organization and finally conduct the radical changes. In fact, COVID-19 has brought a lot of innovation to digital payment, especially on how Islamic banks can simplify the technology. Today, amid the coronavirus pandemic, digital payment is one of the most important elements, with examples such as one-touch payment systems using barcodes in smartphones without using any types of cards or using a card with a contactless payment feature to just tap on a point-of-sale machine.

Despite all of the aforementioned challenges, the Islamic finance and banking industry in Oman is encouraged to provide more new innovative products that are suitable for a post-COVID-19 era so that it is able to tackle the upcoming challenging year. As such, Islamic banks should update their strategy according to the current market trend and develop new products that are suitable for their customers, not only for the purpose of the growth of the industry but also to support the economy of the country.