



Navigating Through Rough Waters



2008-2009 Islamic Banking Competitiveness Report
World Islamic Banking Conference
Bahrain, 23-24 November, 2008

McKinsey & Company

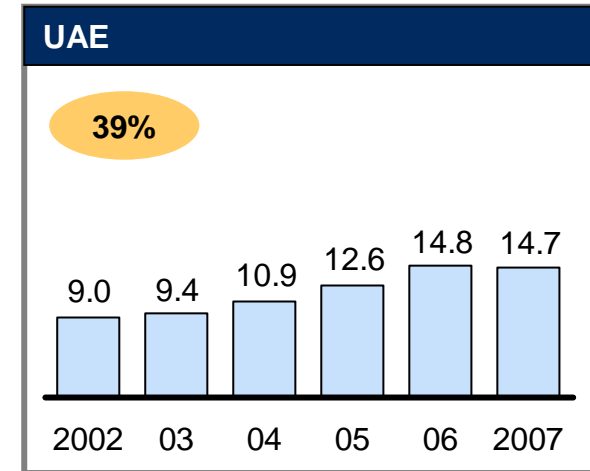
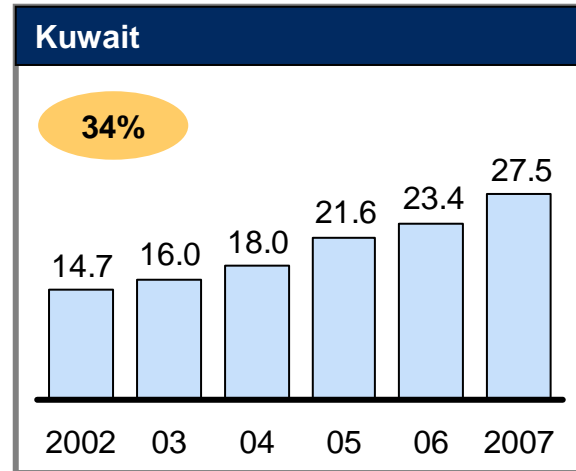
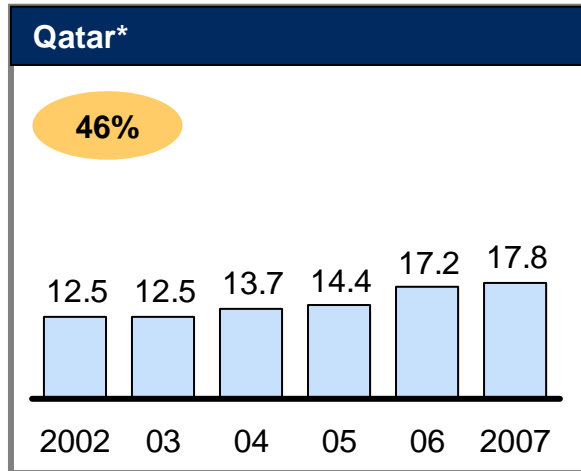
Islamic assets ended 2007 with high growth in all key markets...

Islamic assets as part of total banking assets, %

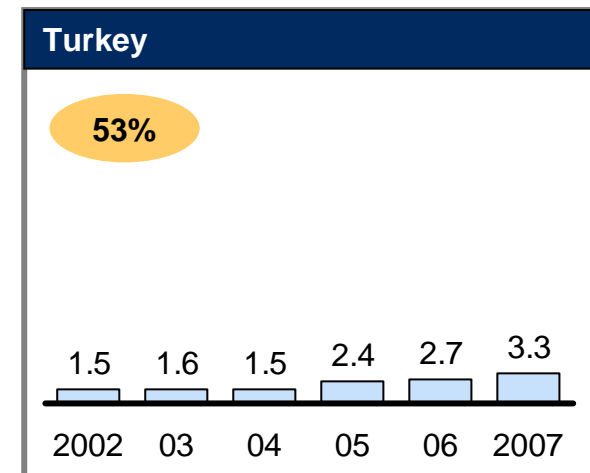
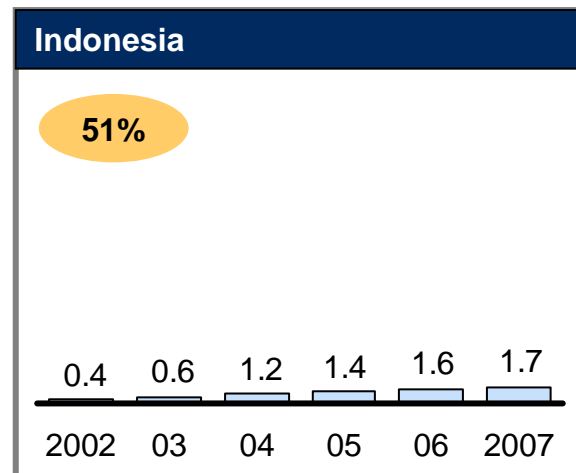
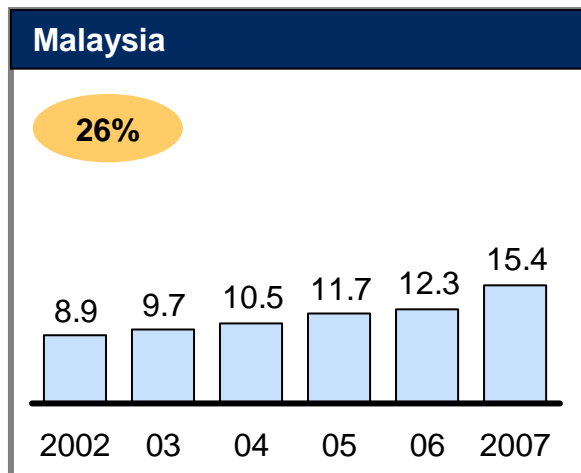
SELECTED MARKETS

XX Growth in Islamic asset base, CAGR (2002-07)

GCC markets



Other markets



* Excluding Doha Bank

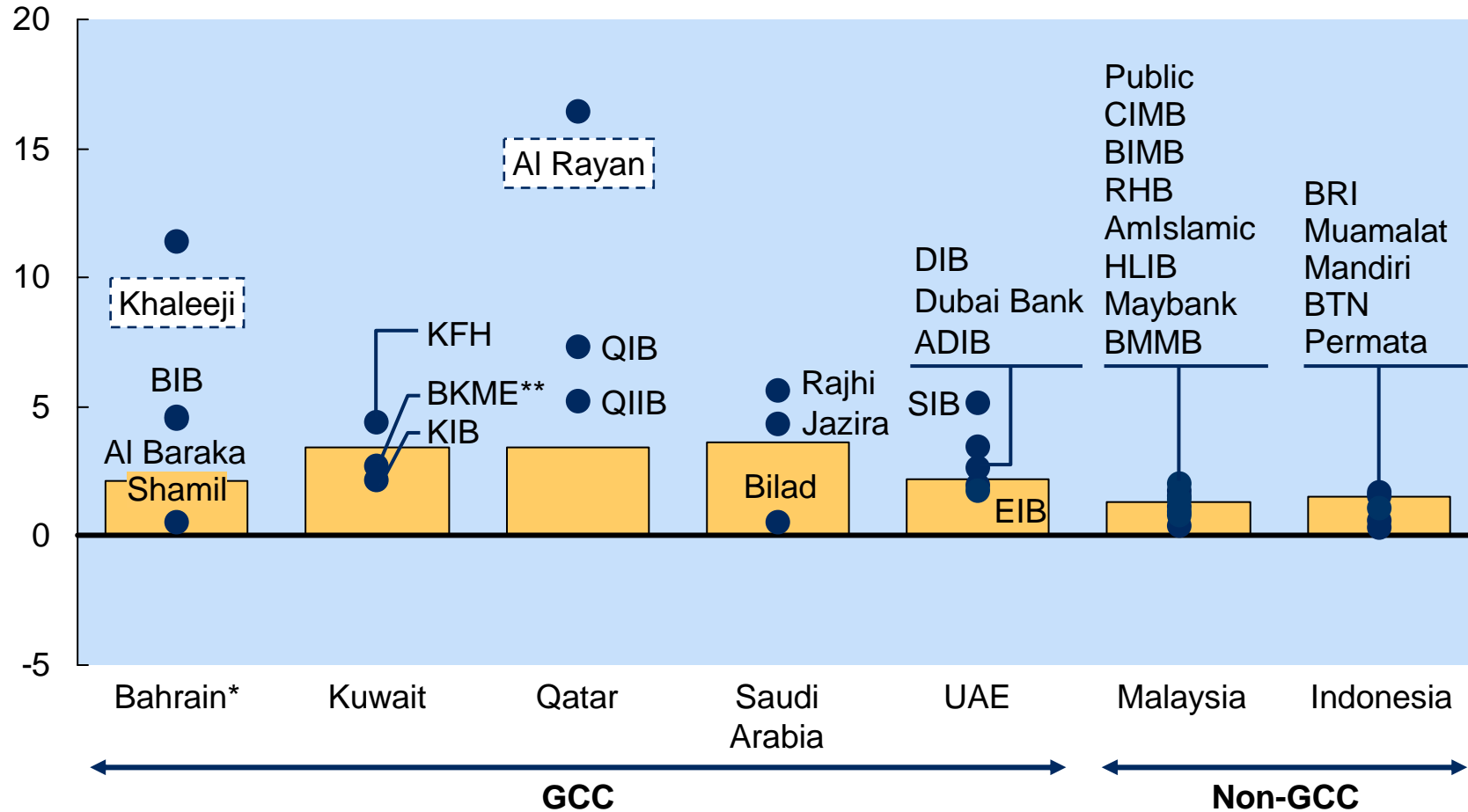
Sources: Central banks; bank annual reports; Capital Intelligence reports; Zawya; team analysis

Islamic banks also achieved strong profit performance in 2007

- Islamic banks
- Top 5 banks
- Recent entrants

Return on Average Assets

2007, %



* Onshore only

** Recently converted to Islamic

Source: Central banks; annual reports; Bankscope; team analysis

2008 is turning out to be one of the most difficult years in financial history

LIBOR – US dollar 3-month spread to treasuries

bps



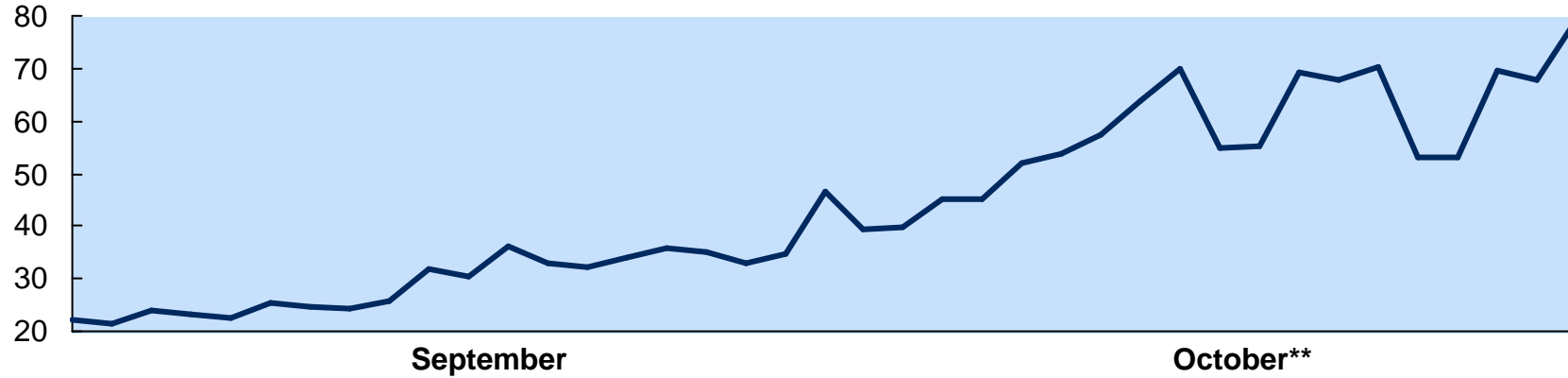
2007		2008	
<p>H2 06</p> <ul style="list-style-type: none"> • Home prices begin to fall after loose credit and massive growth in MBS lead to record increases 	<p>H1 07</p> <ul style="list-style-type: none"> • New Century Financial Corporation files for bankruptcy • Bear Sterns \$3B loan to rescue internal fund with subprime losses 	<p>H2 07</p> <ul style="list-style-type: none"> • BNP Paribas freezes 3 funds • Countryside draws \$12B on credit lines • Northern Rock run on bank; BoE to rescue 	<p>H1 08</p> <ul style="list-style-type: none"> • Societe Generale announces \$7B trading loss • Countryside acquired by BofA • Bear Sterns acquired by JP Morgan with \$29B Fed backing • Discount window opened to primary dealers

* Through October 27, 2008

Source: Bloomberg ; company reports; press search ; team analysis

Events in just the past two months have caused volatility to jump four-fold

CBOE VIX Volatility Index*



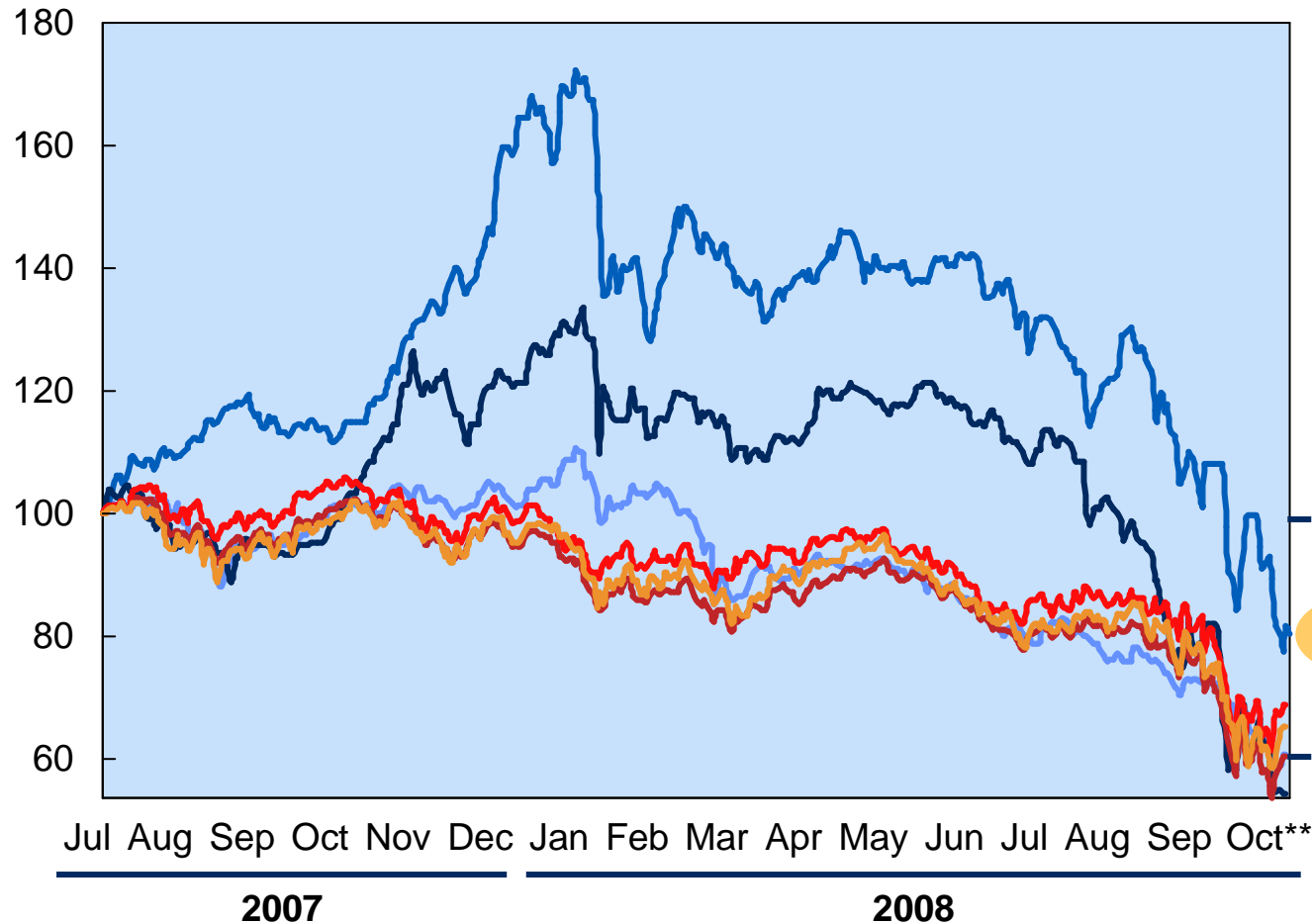
Wk 1 and 2	Wk 3	Wk 4	Wk 1	Wk 2 and 3
<ul style="list-style-type: none"> • Fannie Mae and Freddie Mac in US conservator-ship; \$200B at risk • Lehman Brothers files for bankruptcy • Merrill Lynch acquired by Bank of America • Short selling of financial stocks prohibited • \$700B bailout plan proposed by US Treasury 	<ul style="list-style-type: none"> • Goldman Sachs and Morgan Stanley convert to bank holding companies • Washington Mutual placed under the receivership of the FDIC 	<ul style="list-style-type: none"> • Fortis nationalized by Benelux governments • Wachovia acquired by Citi • Dow Jones sees largest one day drop in history • \$700B bailout plan passes • European governments pass laws increasing federal deposit guarantees 	<ul style="list-style-type: none"> • Iceland seizes all its major banks; government and banks loans downgraded • S&P500 sees steep drops not seen since the Great Depression • World stock markets collapse, triggering trading suspension in several markets • Central banks from all over the world announce rate cut 	<ul style="list-style-type: none"> • Global stocks post record highs after G7 emergency meeting and new guarantees • US Treasury takes \$250B equity in largest banks • UAE adds another \$19B in liquidity to its banks and provides deposit guarantees • DJIA suffers largest percentage drop since 1987 • Iceland becomes the first western country to request an IMF loan since 1976 • Inability to borrow money forces several other countries to seek IMF funding

* Chicago Board Options Exchange Volatility Index

** Through October 24, 2008

Equities in key markets have not been immune to the global financial crisis

Equity market performance
Indexed to 100 in July 2007



LOCAL / REGIONAL

- Kuala Lumpur Index
- Saudi Arabia Index
- MCSI* UAE Index

GLOBAL / MATURE MARKET

- MSCI* World Index
- Dow Jones Industrials
- FTSE 100

Markets in fear of a recession in the OECD and a wider global slow down

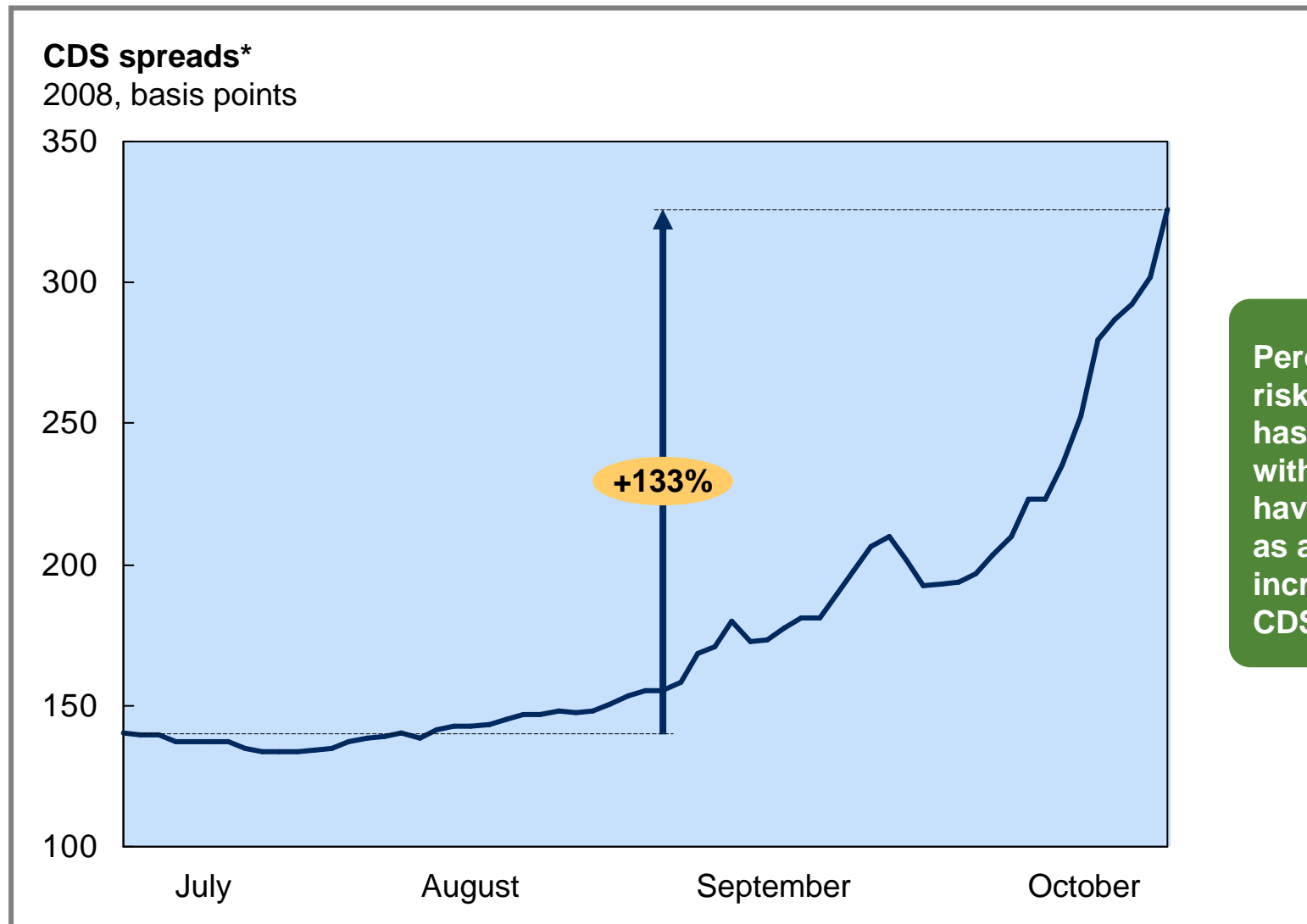
40%

Almost all markets have been affected to the same extent

* Morgan Stanley Capital International Index

** Through to October 31, 2008

CDS spreads of leading banks have widened considerably



Perceived lending risk in the market has skyrocketed, with some banks having as much as a 260% increase in their CDS spreads

* CDS spread average of EBI, DIB, Maybank, ADCB, Samba, CBQ, NBAD and NCB starting from July 18, 2008 through to October 10, 2008

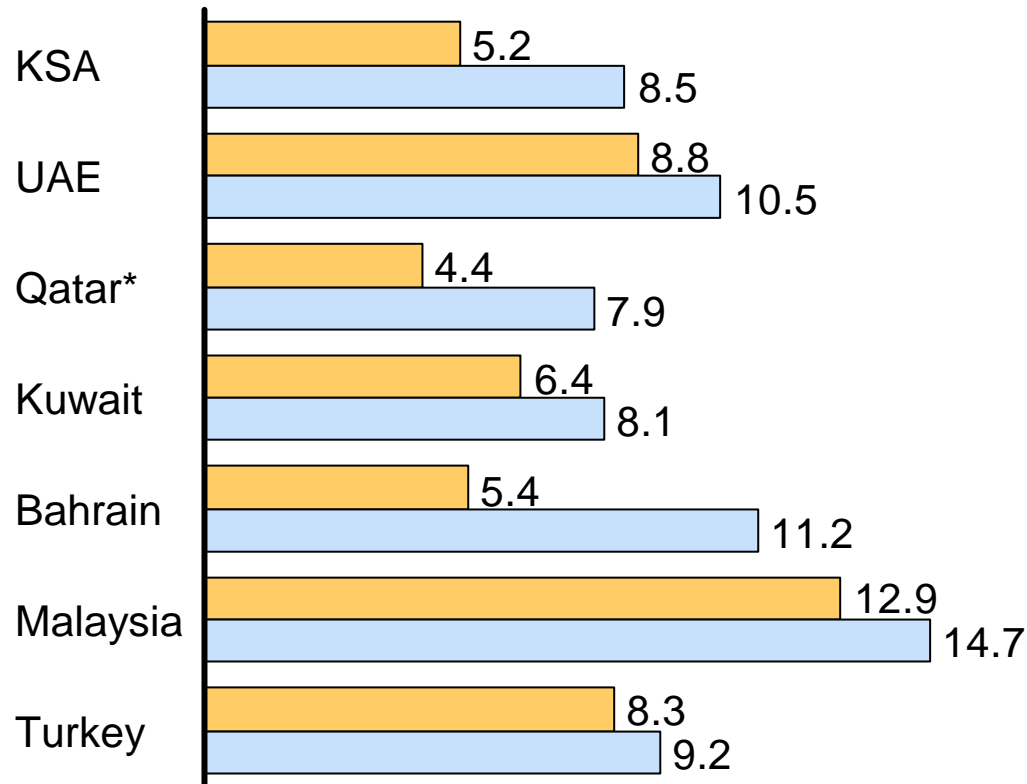
Islamic banks are less leveraged than their conventional peers

Asset-to-equity ratios

2007 (year end) - Asset weighted average

Islamic banks
Conventional banks

By country

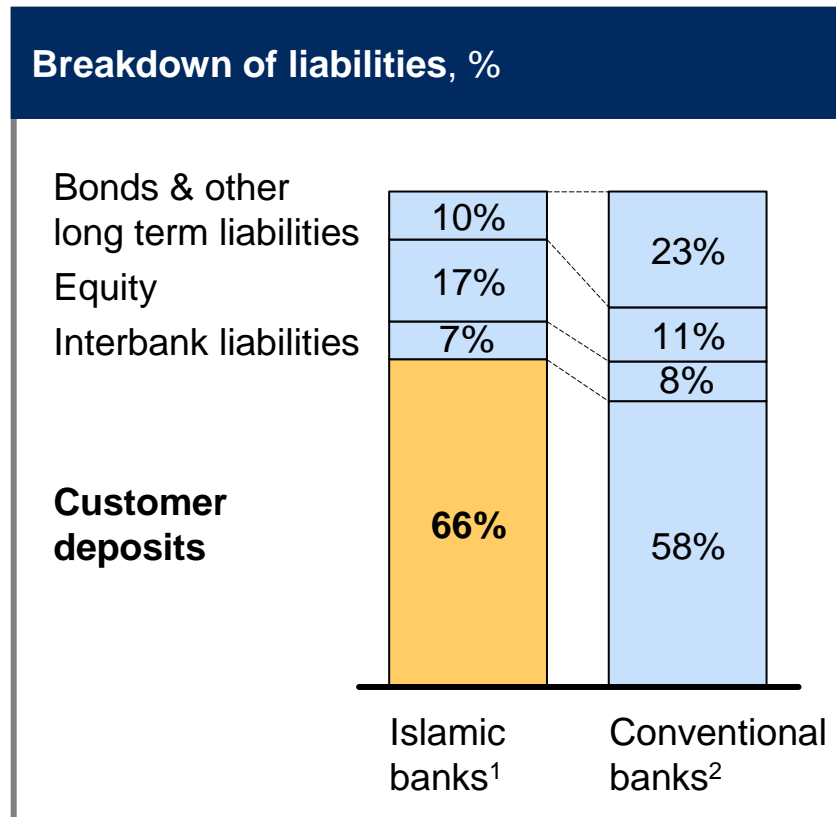


* Excludes Masraf Al Rayan

Source: Bankscope; bank annual reports; team analysis

Islamic banks are more reliant on customer deposits for liquidity

Consolidated commercial bank balance sheets across the KSA, Kuwait, Qatar and the UAE, 2007



“
People will be more comfortable depositing their money in Islamic banks because of their perceived better liquidity position.
 ”
 - Senior manager of conventional bank

¹ Includes all Islamic banks in the UAE, KSA, Kuwait and Qatar

² Includes all conventional banks in the UAE, KSA, Kuwait and Qatar

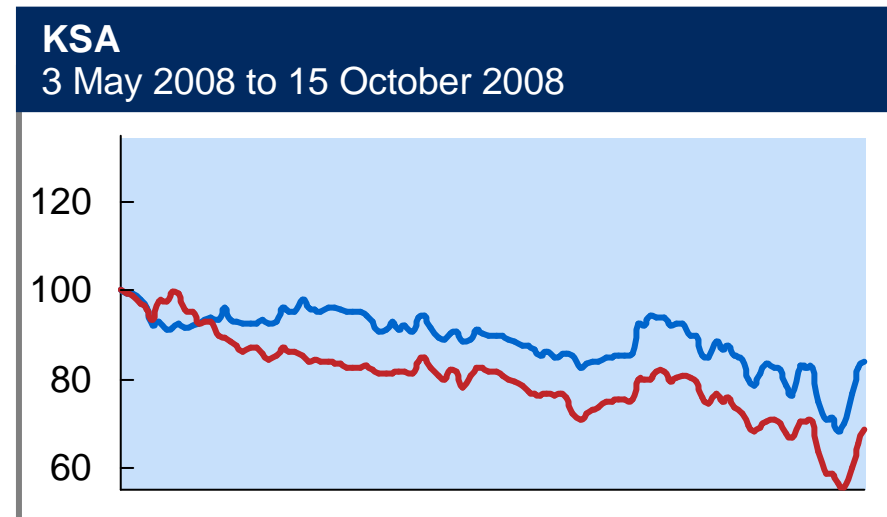
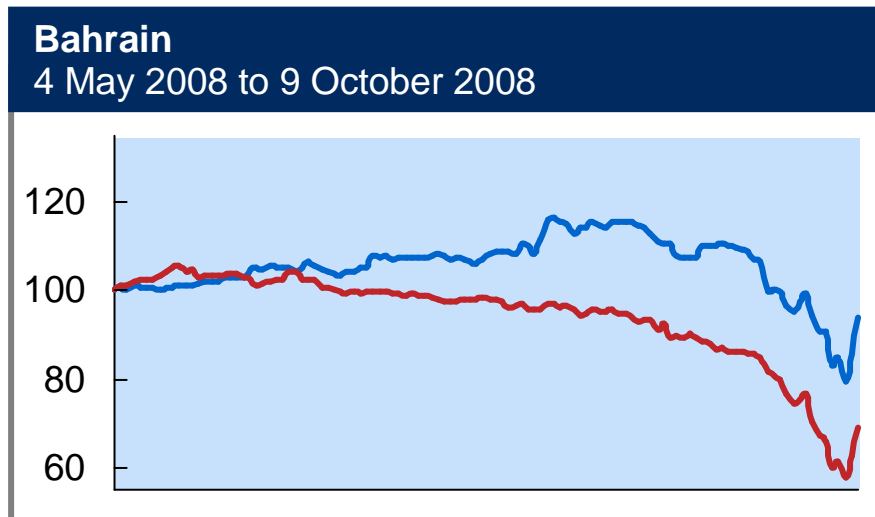
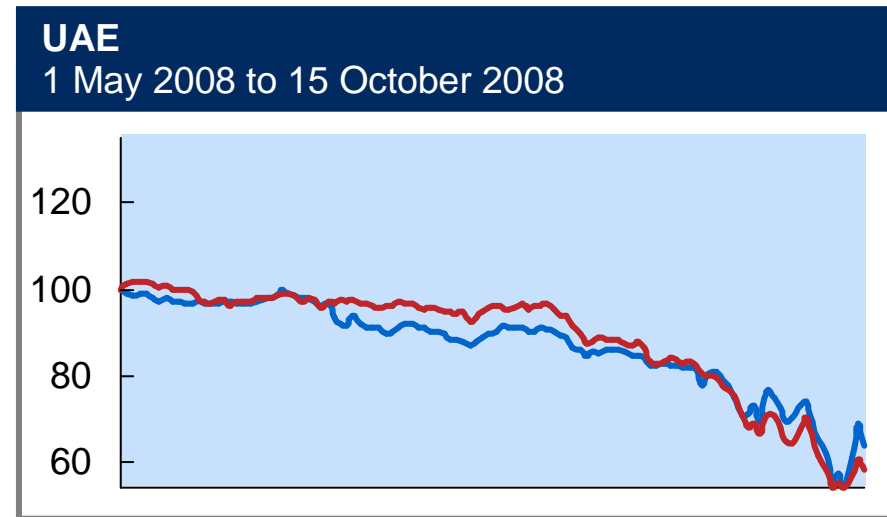
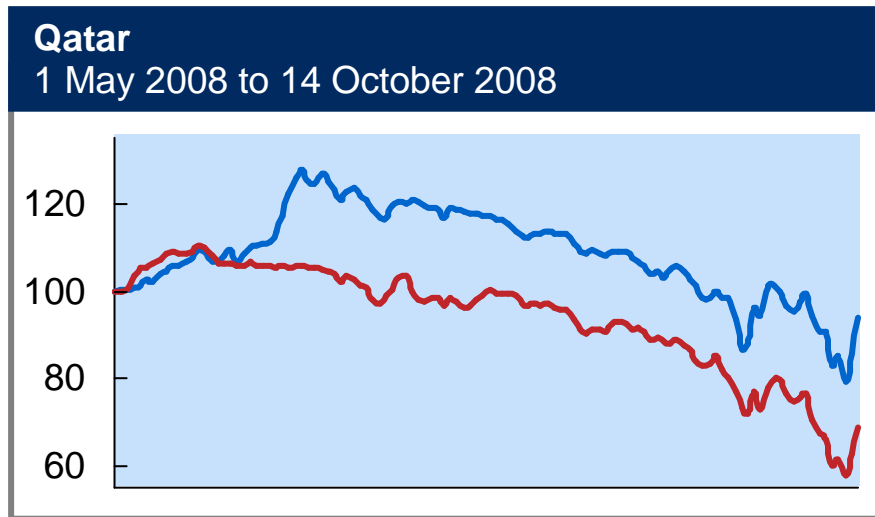
Source: Central banks; annual reports; Zawya; team analysis

Islamic financial institutions market values have also largely tracked the market

Total market value

Starting point indexed at 100

— Conventional banks
— Islamic banks



How to look at the future now?

Approach

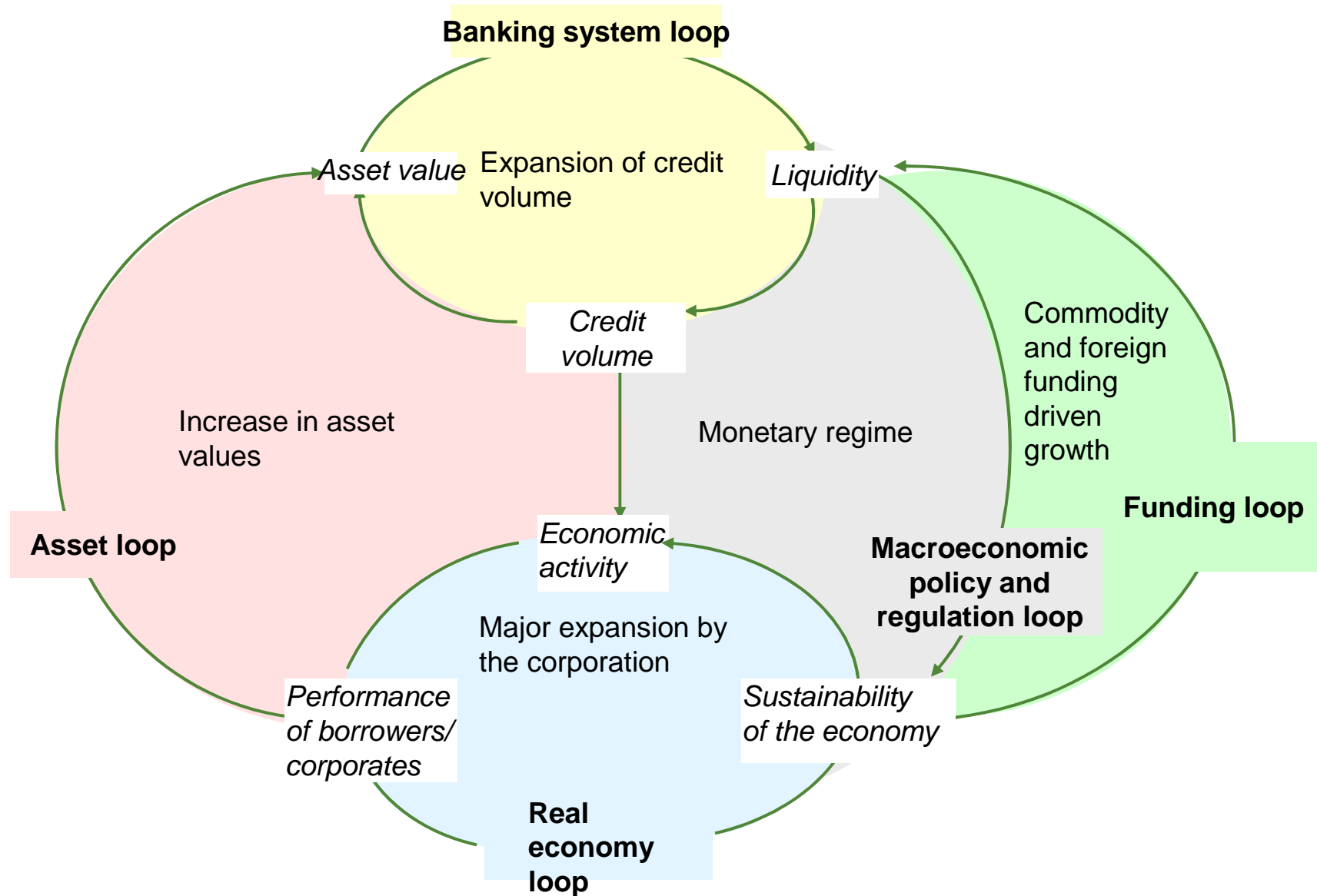
- Assume we do not (yet) fully understand
- Prepare for the worst, hope for better
- Think from the future and work our way back
- Seek full transparency in the organization, and no sacred cows
- Act quickly – not months or weeks, but days will matter

Implications

- Need to understand the macro picture first
- Identify the major risks, review exposures
- Take tactical short term actions as well as strategic long term moves

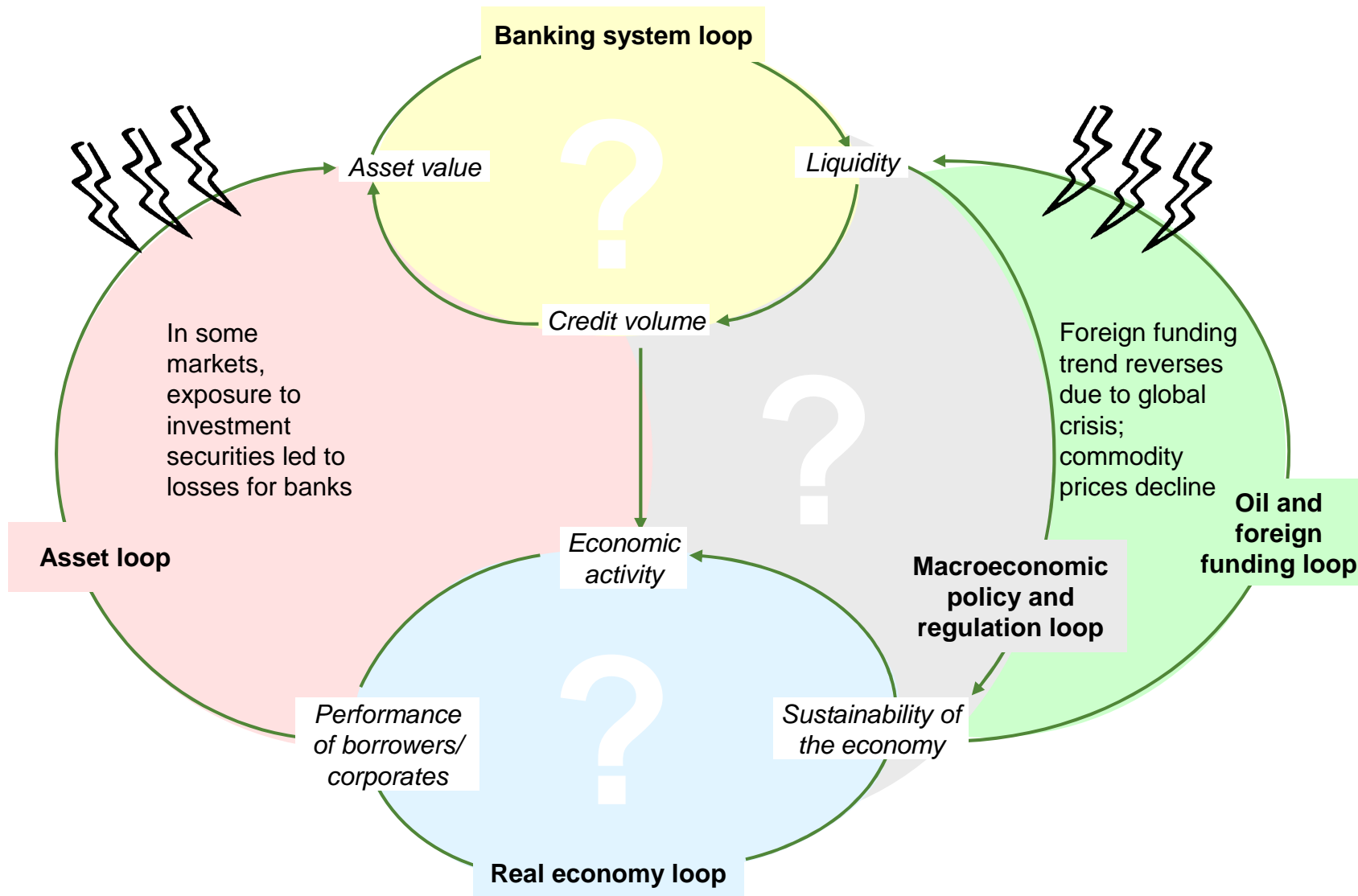
It is important to understand the macro drivers ...

SIMPLIFIED



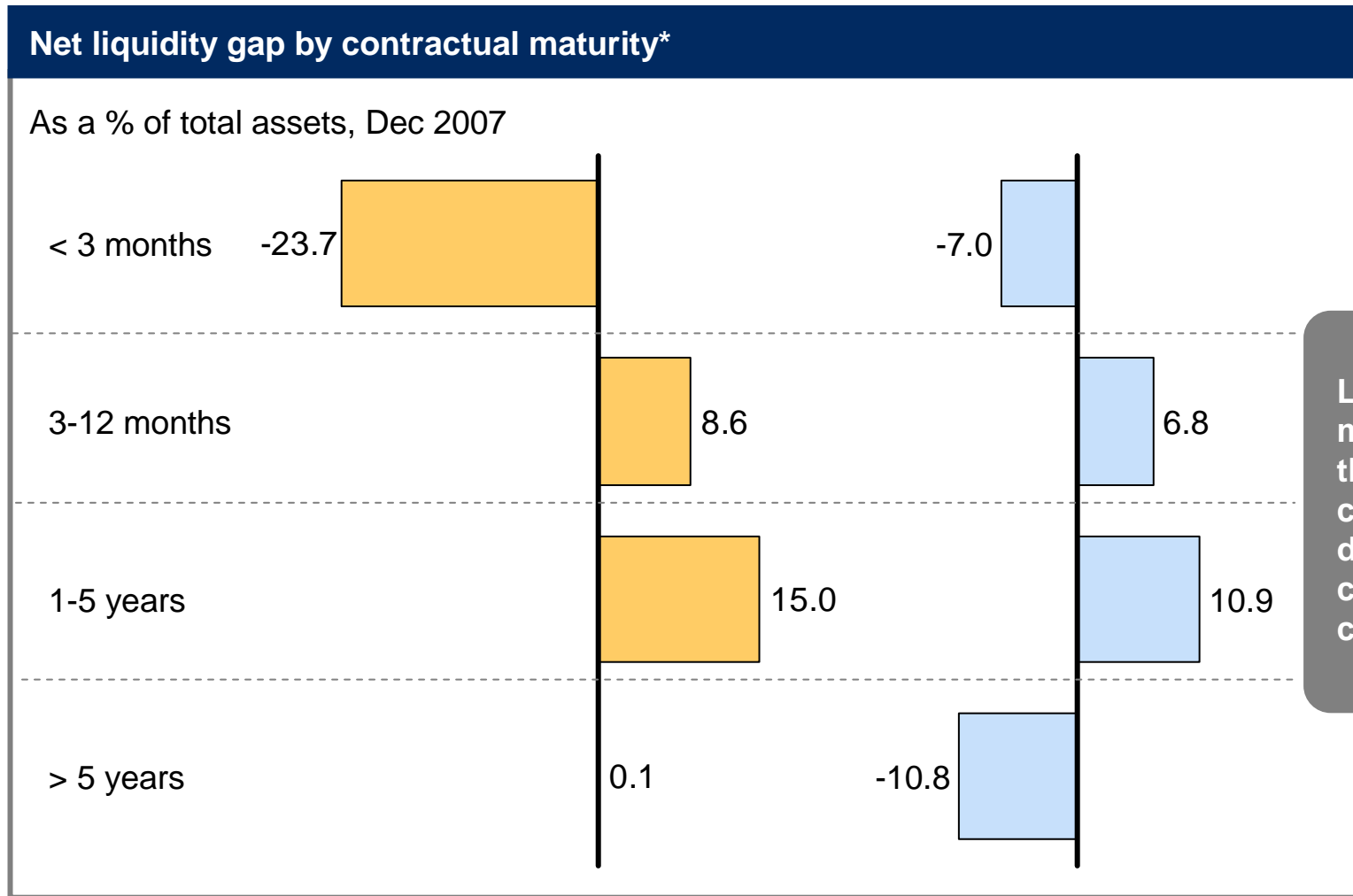
And how they could impact one's business

SIMPLIFIED



Islamic Banks do face liquidity management risk

Islamic banks
Conventional banks

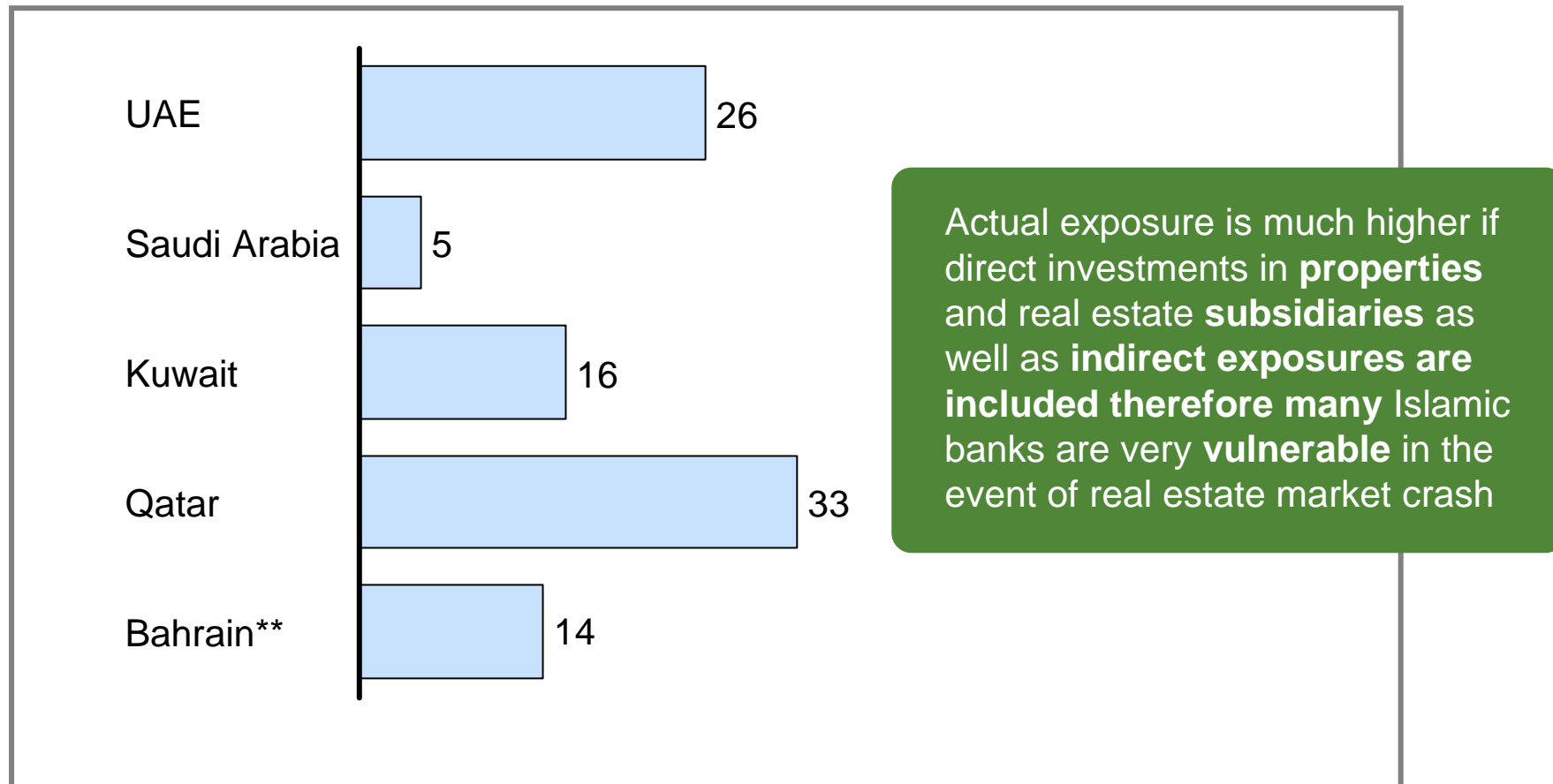


* From a sample of the 7 largest Islamic and Conventional banks in the GCC
Source: Bank annual reports ; team analysis

In several countries, Islamic banks are exposed to real estate, and a potential market correction could be a serious source for concern

NOT EXHAUSTIVE

Reported exposure of Islamic Banks to construction and real estate assets*
2007 (year end) – percent of total lending



* Only includes real estate and construction assets as reported and identifiable in the financial statements

** Only Includes top 3 onshore Islamic banks

Source: Central banks; annual reports; team analysis

Action will need to be on two fronts

I

Work our way through the crisis

- Manage liquidity – Carefully monitor liquidity needs and ensure sufficient sources and level of capital available
- Measure main exposures by asset class and stress test positions
- Ensure appropriate level of credit risk management and strong collection capabilities
- Create scenarios for possible evolution of the sector, and define possible challenges and opportunities

II

Work with a “through the cycle” mindset

- Drive operational excellence to close the efficiency gap with conventional banks
- Focus on managing growth in core Islamic banking segments

I All institutions need to ask a set of questions and seek answer

1 Have I taken all measures at my disposal to manage liquidity?

2 Is my institution resilient enough to cope with an unprecedented down cycle?

3 Is my corporate business prepared well enough to avoid excessive losses and navigate through the anticipated down cycle?

4 Have we developed the skills and capabilities to manage risks associated with our fast growing and increasingly complex retail business?

5 Does anyone in my institution have the confidence to say how much we could possibly lose through our investments and trading positions?

6 What is my institution's plan to handle a potential real estate slowdown?

I Sound risk management can start to be put into place immediately

1-to-4-week measures

- Liquidity oversight at CEO level
- Holistic balance sheet management and stress testing that goes beyond reporting of interbank flows and short term cash flow projections
- Active targeting of large depositors
- Launching structured deposit products
- Re-pricing of credit lines
- Reposing or sale of securities

1-to-3-month measures

- Review and adapt 2009 business plan and budget
- Review cost projections and set target levels
- Identify quick-wins in cost reduction
- Undertake tactical initiatives to enhance bottom line (e.g., pricing)
- **Develop a good understanding of capital consumption by business line**
- **Reduce exposure to capital consuming non-strategic businesses**
- Define a target balance sheet structure and funding model

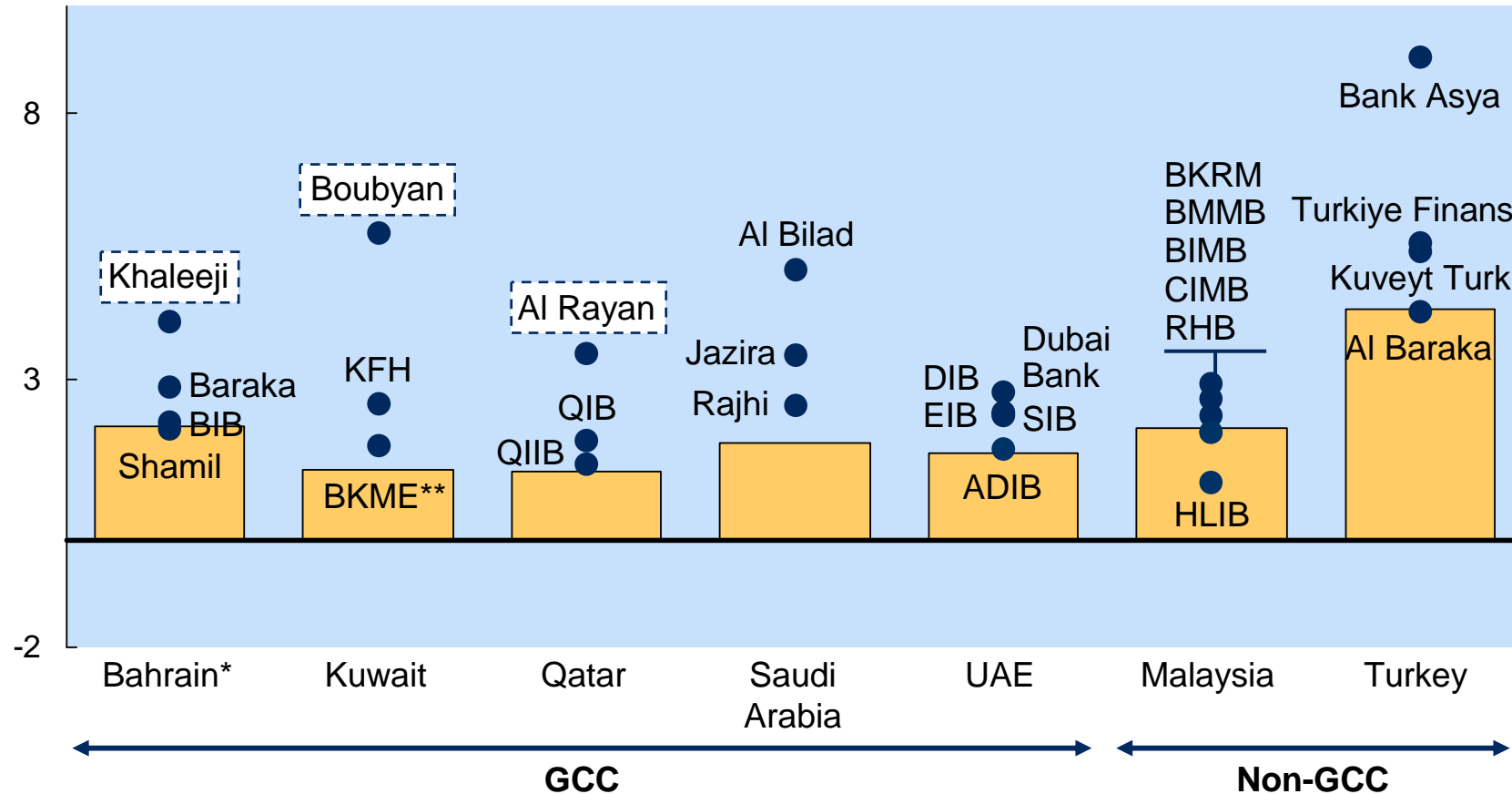
1-to-12-month measures

- **Diagnose risk management function and close gaps in priority areas (e.g., remedial, collections)**
- Improve the supporting infrastructure for liquidity risk measurement and monitoring (modelling, including stress tests, systems)
- Review and adapt corporate strategy and business model
- Conduct a structured cost rationalisation and operational improvement programme

II There is still a significant operational gap between Islamic and conventional banks

- Islamic banks
- Total banking sector
- Recent entrants

Operating costs as a %age of average assets
2007, %

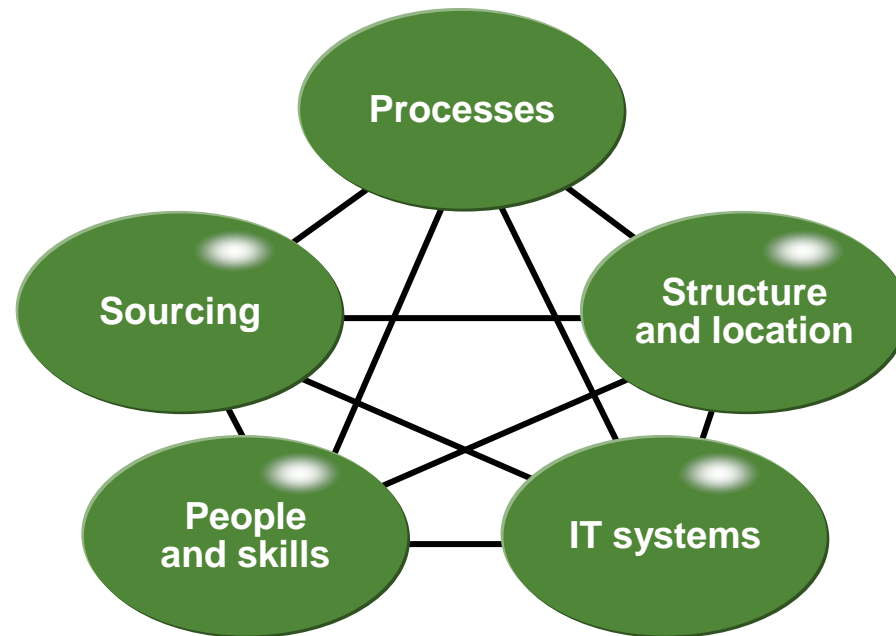


* Onshore only

** Recently converted to Islamic

Source: Central banks ; annual reports ; Bankscope ; team analysis

II Specific cost initiatives can help close operational gaps



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There are opportunities in all business lines if you can manage the risk!

- Retail banking
- Wealth Management
- Wholesale banking
- Takaful

Thank You!