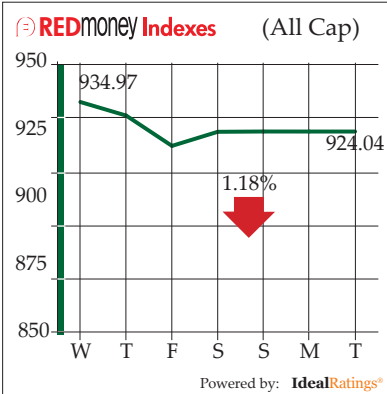


Islamic Finance *news*

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Takaful 2013: A risky business

The Takaful industry worldwide has seen exceptional growth in recent years, achieving double-digit figures in most key markets including Malaysia and the GCC. However, Islamic Finance news believes that despite this optimism there are a number of key factors which if not addressed have the potential to seriously inhibit the market. This week we take a look at these limitations, and examine the impact they are having on the continued development of the industry.

Much has been said about the various factors limiting the expansion of the Takaful industry from a retail perspective: including lack of awareness from customers, the absence of a clearly defined value-added service, the lack of a coherent and standardized supervisory structure and the difficulty of competing with conventional insurers. But what about the constraints arising on the other side of the coin – specifically from the market itself, and the investment opportunities it offers.

“The Takaful industry has seen rapid growth in recent years outpacing the growth of the Islamic finance industry as a whole,” says Mahesh Mistry, the director of analytics at AM Best, global insurance ratings agency. And unlike their conventional counterparts, Takaful and re-Takaful operators are restricted to Islamic instruments and are therefore limited in their investment options, particularly regarding highly-rated investment instruments. “Despite the expansion of Islamic finance,” says Mistry, “this has still led to concentration risk in either an asset class, an Islamic entity or even by territory. The ability to create a diversified portfolio is a major challenge for many Takaful and re-Takaful operators.”

Limited paper

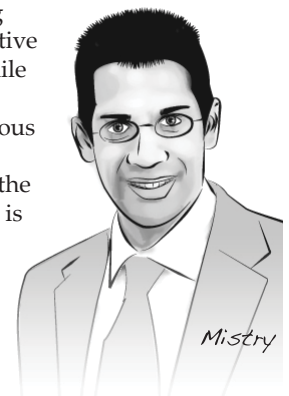
Industry practitioners agree that there

is a serious issue in terms of the lack of quality investment instruments for the industry. “There is a tremendous struggle,” confirms Khaled Khaleif, a senior financial manager at UAE-based Takaful Re. “When compared to conventional investments, [the availability of] Shariah compliant instruments is very low. There is a limitation of all types of Shariah compliant paper, especially high grade paper. Institutions and governments need to recognize the high demand for Shariah compliant products and services and allocate capital to meet these demands.”

Sohail Jaffer, the deputy CEO of FWU Global Takaful Solutions, agrees. “Governments, central banks and the International Liquidity Management Corporation (ILMC) need to increase the supply of suitable Shariah compliant securities. For Shariah compliant annuities, long-dated Shariah compliant securities remain in short supply while in several emerging markets there is a shortage of domestic Shariah compliant investments.”

A further issue for re-Takaful firms in particular is the challenge of ensuring that liabilities are adequately covered by sufficient liquid assets to meet claims obligations. “Given the limitations of Islamic instruments,” explains Mistry, “they tend to generate a lower level of investment return than conventional products, making them a less attractive proposition”. While this has not yet turned into a serious issue for most providers yet, as the industry grows it is likely to become ever more compelling.

continued on page 3



Mistry

A fine example of
Shariah inspired innovation.

CIMB ISLAMIC

Muslim countries of north Asia: the time has come to re-open the Silk Road

The countries of central and north Asia are a natural fit for Islamic finance, with predominantly Muslim-majority populations and a wealth of natural resources and investment opportunities. ANTEA BRUGNONI examines the current state of play in the region as neighboring countries jockey for position as a regional Islamic finance hub.

In April 2012, Dubai Culture hosted a comprehensive exposition on the Islamic heritage of Uzbekistan. The set-up of this event, widely acclaimed through-out the Middle East cultural scene, featured Uzbekistan – a country that gave birth to pillars of Islamic thought such as Imam Bukhari, the key commentator of the Qur'an and Hadith compiler – as one of the brightest spots of culture and civilization in Islamic history that today strives to maintain its heritage while modernizing the economy. With one of the world's largest production of cotton and huge gas and mineral reserves, its entry in the Islamic finance arena is being closely monitored by the international community eyeing its 28 million population – 88% of which are Muslim – as a potentially lucrative market.

Yet Uzbekistan is struggling to develop a modern infrastructure and is teaming up with international players to properly address the growing expectations of its population. An exemplary step in this direction is the recent IDB's US\$37 million 14-year financing that will be used to purchase medical equipment for the modernization of oncological institutions in the country. The project, whose total amount is US\$83 million, is one of the 15 projects currently jointly implemented by the Uzbek government and the IDB in the fields of health, education, agriculture, energy and transport, with a total value exceeding US\$400 million.

On the retail side, Hamkor Bank is gearing up to provide Islamic banking services across the country leveraging on the bank's wide network. "Shariah compliance and Islamic human capital development will be privileged so that Islamic banking can be initiated in Uzbekistan with sound foundations", says Ikram Ibragimov, the chairman of Hamkor Bank. Uzbekistan is not the only country in the region to have realized the opportunities offered by Islamic finance and competition is rife between countries to conquer the Islamic finance pole position in central and north Asia.

Kyrgyzstan, for instance, has approved legislation regulating Islamic banking, just before the 2010 political transition that ushered in a new government. This formal move came after the implementation by EcoIslamic Bank of a three-year state-supervised and IDB-aided pilot project. This bank was created in 1997 by a local entrepreneur using the facilities of a local branch of Russian Credit Bank, with the name of EcoBank. It now aims to offer Islamic finance as a possible alternative to the conventional banking system in the country.

Furthermore, the establishment in 2011 of a Bishkek-based brokerage agency, with the aim of finding investors for Shariah compliant small and medium sized business ventures, represents a further step towards the widening of Islamic finance businesses in the country and has helped dispel fears of the secular elite towards the mixing of religion and finance.

More recently, in neighboring Azerbaijan, where 93% of the 9 million population is Muslim, an Islamic finance window has been opened by the country's largest lender, the International Bank of Azerbaijan, to provide financing to small companies. Here again, the IDB has funded several infrastructure projects for a total amount of US\$1.2 billion, though the real challenge for the development of Islamic finance in the country remains the creation of a legal framework to regulate the industry and allow commercial banks to issue Sukuk and expand their operations.

In this respect, Kazakhstan, another country striving to become the regional Islamic finance hub, in July 2012 issued a US\$75 million Sukuk, the region's first, and is now working actively to expand its product offering. Abu Dhabi's Al Hilal Bank, set up in Kazakhstan in March 2010, is managing investments worth more than US\$170 million and is expanding its presence in the public sector through, for example, a US\$10 million agency agreement with KazPost.

Afghanistan is discussing a new Islamic finance law while at the same time preparing the guidelines to allow the launching of Takaful operation in the countries. Several ministries and agencies are looking at Islamic finance products as an effective tool to facilitate the development of rural areas and the central bank is mulling over the issuance of a debut sovereign Sukuk

“ The real challenge for the development of Islamic finance in the country remains the creation of a legal framework to regulate the industry ”

Investments, business opportunities, request for Shariah compliant savings products are on the radar of governments and creative entrepreneurs in the central and north Asian countries. Afghanistan, Uzbekistan, Turkmenistan, Tajikistan, Georgia, Azerbaijan and Kyrgyzstan are all, in a way or another, moving towards the implementation of a sustainable Islamic economic and financial environment.

Though the road ahead will be bumpy, they aim at regaining their ancient leading position of industrial and cultural centers of the Muslim world. The role of Islamic finance in helping to attain this goal will be discussed at the New Silk Road Forum that will convene in London on the 7th March. ☺

Antea Brugnoli is the head of product development at ASSAIF. She can be contacted at product.development@assaif.org.