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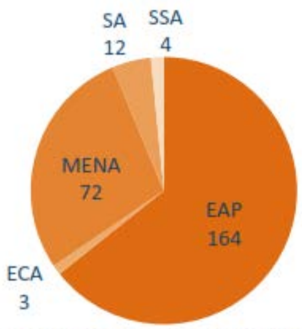
Islamic Finance and inclusion
Debt rather than growth?

Figure 1. Number of Institutions



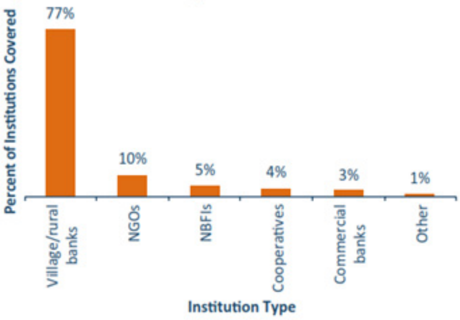
Note: EAP = East Asia and Pacific; ECA = Europe and Central Asia; MENA = Middle East and North Africa; SA = South Asia; SSA = Sub-Saharan Africa

The demand for greater financial inclusion is considerable. Millions of people around the world are currently unable to access financial services, due to their cost, lack of access, and poor financial education. According to 2012 figures from the Global Financial Inclusion (Global Findex) database, over 2.5 billion adults are thought to lack a formal bank account. The same proportion is also worrying for Islamic financial products. Although Islamic financial assets represent less than 1 percent of total global financial assets, total funds were valued at $1.3 trillion in 2011, a 150 percent increase over five years (Reuters, 2011). Policymakers around the world have noted this trend of rapid and sustained growth. For instance, in a 2012 op-ed, then-World Bank Managing Director Mahmoud Mohieldin wrote that Islamic finance “has the potential to meet more people’s banking and investment needs, expand its reach, and contribute to greater financial stability and inclusion in the developing world” (Mohieldin, 2012). In March of 2013, the International Finance Corporation announced its first partnership with an Islamic finance institution in Sub-Saharan Africa, a $5 million equity investment with Gulf African Bank in Kenya with the explicit goal of expanding Sharia-compliant banking products and services to small and medium businesses (IFC, 2013). Sharia-compliant financial inclusion represents the confluence of two rapidly growing sectors: microfinance and Islamic finance. With an estimated 650 million Muslims living on less than $2 a day (Obaidullah and Tariqullay 2008), finding sustainable Islamic models could be the key to providing financial access to millions of Muslim poor who strive to avoid financial products that do not comply with Sharia (Islamic law). Consequently, Sharia-compliant financial inclusion has recently galvanized considerable interest among regulators, financial service providers, and other financial inclusion stakeholders. However, despite a four-fold increase in recent years in the number of poor clients using Sharia-compliant products (estimated at 1.28 million) and a doubling in the number of providers, the nascent sector continues to struggle to find sustainable business models with a broad array of products that can meet the diverse financial needs of religiously observant poor Muslims.

Financial tenets enshrined in Sharia challenge the microfinance sector’s ability to sustainably provide Sharia-compliant financial products at scale. One such tenet is the widely known prohibition on interest, which makes traditional microloan models technically impossible. A lesser known tenet is the encouragement of wealth creation through equity participation in business activities, which requires risk-sharing by financial service providers that does not guarantee returns.

Much of this work is based on the premise that Muslims prefer financial services and products that are consistent with their religious beliefs, chief among them the prohibition on interest, or riba, stipulated in the Quran. Yet little empirical research has been done to measure the degree to which Muslims are currently not accessing conventional financial systems, or how much they demand and use Sharia-compliant financial products, particularly within the realm of household finance. Even less is known about how these usage gaps and preferences vary between various financial products and across regions and countries. A more complete understanding of these concepts can help Islamic finance industry leaders better expand their outreach to Muslim clients, and aid policymakers in more clearly defining their role in expanding financial inclusion - Islamic or otherwise - to Muslim adults

Figure 2. Institutions Offering Islamic Microfinance Products



Note: NGOs = nongovernment organizations; NBFIs = nonbank financial institutions

However it seems that the worldwide market is more avid of sukuk deals rather than Islamic growth structured products. Lately the announcement of the opening of Saudi Market was deemed to fuel speculation on Sukuk rather than opening up capital. Saudi Arabia's plan to open its $531 billion stock market to foreigners is prompting analysts' speculation that Islamic bonds will be next. The government's approval of overseas financial institutions to trade equities may herald a similar relaxation of rules in the local-currency primary debt market, according to Mashreq Capital DIFC Limited and Rasmala Investment Bank Limited.

Saudi Arabia capital market authority said that the stock-market change would take place in the first half (H1) of next year. With its assets estimated to total nearly $1 trillion globally, Islamic finance remains tiny compared to conventional finance with its tens of trillions of dollars. The market in Islamic bonds, or sukuk, is believed to total about $50 billion, roughly 1 percent of global bond issuance.

But proponents of Islamic finance can point to impressive gains. Experts believe it had expanded at a compound annual growth rate of 20 percent over the past three years, compared to 9 percent for conventional finance. That performance gap has probably widened further in the last two months as much new business in the West has ground to a halt.

Deutsche Bank, a pillar of traditional banking, estimated in a report this month that Islamic finance would almost double to $1.8 trillion in assets by 2016 as stagnant conventional lending pushed companies to seek alternative financing methods.

As much of the international corporate bond market has frozen up over the last six months, most bond issuance by Gulf companies has been in the form of sukuk. Dubai's fast-growing Emirates airline said it was looking at the Islamic finance market to fund aircraft deliveries as European banks backed out of plane deals because of the euro zone debt crisis.

Some big Western banks, facing tough conditions in the funding markets on which they have long relied, are also turning to sukuk. HSBC issued a $500 million sukuk in May and Goldman Sachs announced a $2 billion sukuk program last month. French bank Credit Agricole has said it is considering issuing an Islamic bond or creating a wider sukuk program that could lead to several issues.

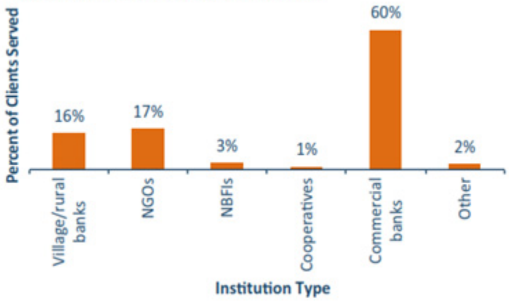
This year's Arab Spring uprisings in North Africa have installed governments, which are expected to promote Islamic finance more enthusiastically than their authoritarian predecessors, partly because it can help them attract Islamic investment funds in the Gulf.

Designing Islamic instruments for monetary operations has proven conceptually difficult. In countries with a dual banking system, the lack of noninterest-bearing securities has limited the scope of monetary management. The liquid nature of banks' liabilities, related to the predominance of deposits of short-term maturities, predisposes the system to hold substantial liquid assets and excess reserves. This, in turn, inhibits financial intermediation and market deepening. Difficulties in defining rates of return on these instruments have also constrained the development of money and interbank markets.

Developing these markets is indispensable for the conduct of monetary policy and financial market deepening. The inadequate development or absence of these markets in many countries constrains central bank intervention through indirect instruments and has occasionally encouraged the use of direct controls on credit. The absence of well-organized, liquid interbank markets—that can accept banks' overnight deposits and offer them lending to cover short-term financial needs—has exacerbated banks' tendencies to concentrate on short-term assets.

Progress in effective liquidity management calls for adopting a comprehensive, integrated approach to developing money and securities markets. It would also require establishing an efficient lender of last resort facility; developing well-suited interbank instruments for active interbank trading or for monetary operations; actively utilizing securitization techniques to manage the maturity and risk spectrum of assets and liabilities; and making available risk management and hedging instruments, which presupposes the resolution of various legal, institutional, and accounting issues.

Figure 3. Client Reach, by Type of Institution



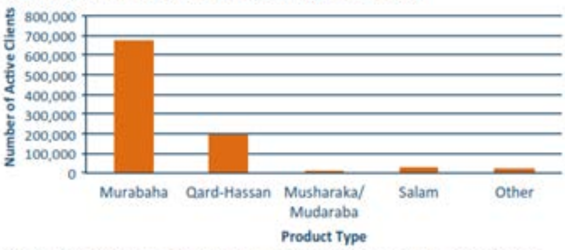
Regulating and supervising Islamic finance

Undoubtedly, one of the biggest challenges is developing a framework for governing, supervising, and regulating Islamic banks. To begin with, there is no common approach among countries where Islamic banking exists. One of the two main views—held by regulators in Malaysia and Yemen, for example—is that Islamic banks should be subject to a supervisory and regulatory regime of central banks that is entirely different from that of conventional banks. The second main view recognizes the uniqueness of Islamic banks' activities, but favors putting them under the same central bank supervision and regulatory regime as that for conventional banks, with slight modifications and special guidelines that are usually formalized in occasional central bank circulars. Bahrain and Qatar are examples of countries that practice this latter form of central bank supervision and regulation.

Since the late 1990s, however, the Islamic banking world has stepped up efforts to standardize regulation and supervision. The Islamic Development Bank is playing a key role in developing internationally acceptable standards and procedures and strengthening the sector's architecture in different countries. Several other international institutions are working to set Sharia-compliant standards and harmonize them across countries. These include the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Islamic Finance Service Board (IFSB), the International Islamic Financial Market, the Liquidity Management Center, and the International Islamic Rating Agency.

A number of countries and institutions have adopted accounting standards developed by the AAOIFI, which complement the International Financial Reporting Standards. The IFSB aims to promote the development of a prudent and transparent Islamic financial services industry and provides guidance on the effective supervision and regulation of institutions offering Islamic financial products. The IFSB has recently finalized standards on capital adequacy and risk management, and has made progress in developing standards on corporate governance. Once developed and accepted, these international standards will assist supervisors in pursuing soundness, stability, and integrity in the world of Islamic finance.

Figure 4. Number of Active Clients, by Type of Product



Note: Data from Islamic Bank of Bangladesh Ltd. are not available by product type and some small institutions.

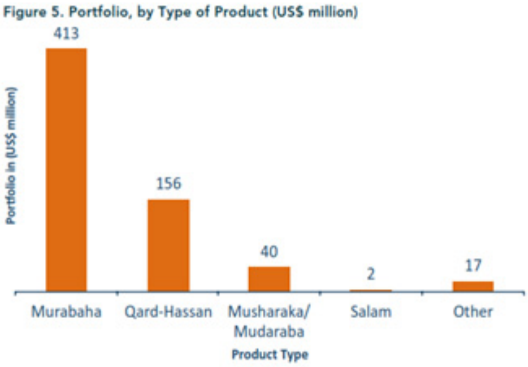
There is an ongoing debate over the fact that Islamic banks do not separate fund management and investment activities from commercial banking. From a supervisory perspective, Islamic banks are often compared with universal banks and mutual funds, which may cause technical difficulties for regulators and supervisors. For instance, an Islamic bank acting as a Mudarib—an agent in Mudaraba, a type of profit-and-loss-sharing (PLS) instrument—might be considered more a fund manager than a bank. Consequently, in these cases, some supervisors support taking the supervisory approaches applied to conventional fund managers. There are instances in which various risks are aggregated into a single Islamic instrument and offered within a single institution (for example, Salam) and the principle of pooled savings and risk sharing in the outcome applies. Closer examination of the character of the underlying transaction is needed for effective supervision, however.

Because of the risks associated with the activities carried out by these institutions and the contracts that govern their mobilization of funds, some argue that their supervision and regulation require a much broader coverage extending beyond the banking sector. Moreover, the risk-sharing nature of liability contracts has raised issues concerning the definition of capital and the capital adequacy ratio.

Some analysts also argue that an appropriate regulatory framework for Islamic banking must place greater emphasis on operational risk management and information disclosure than is normally the case in conventional banking. This argument is based on the specific nature of the risk profile in Islamic financial intermediation, relating to both PLS and non-PLS modes of financing. Investment risk is considered the most critical operational risk affecting Islamic banks' PLS activities. While PLS modes may shift the direct risk to investment depositors, they may also expose Islamic banks to risks normally borne by equity investors rather than holders of debt. PLS modes involve banks in activities that go beyond conventional banking, such as the determination of profit- and-loss-sharing ratios on investment projects. Moreover, banks' exposure is heightened because of the lack of recognizable default on the part of the agent-entrepreneur in PLS contracts, except in cases of negligence or mismanagement.

Saudi Arabia as the world's biggest exporter of oil and de facto leader of OPEC is removing barriers to one of the most restricted major stock exchanges as the government pursues a $130 billion spending plan to boost non-energy industries. The move may lead to the country's inclusion in MSCI indexes, which are used to measure performance by money managers with an estimated $9 trillion of assets.

Figure 5. Portfolio, by Type of Product (US$ million)



Note: Product breakdown is not available from Islamic Bank of Bangladesh Ltd. and some small institutions.

Opening the local-currency sukuk market would give foreign investors access to companies that sold 42 billion riyals ($11.2bn) through a dozen sales in the past year. That's more than three times the amount of dollar Islamic bond sales, which are open to overseas buyers.

In the 12 months, only four dollar-denominated sukuk have been sold in Saudi Arabia. Those came from two issuers, Dar Al Arkan Real Estate Development Co. and Saudi Electricity Co., according to data compiled by Bloomberg. Twelve different borrowers, including National Commercial Bank and Almarai Co, each issued a riyal-denominated Islamic security in the period. The past several years have exposed weaknesses in Islamic finance, however. The industry claims sukuk are safer than traditional bonds because they are effectively certificates of ownership in a real asset, not speculative instruments.

The Dubai debt crisis of 2009 showed this claim to be on shaky ground. Companies such as property developer Nakheel and Jebel Ali Free Zone raised funds through sukuk but were forced to restructure once they found themselves unable to repay creditors.

Similarly, deposits in Islamic banks, which do not offer interest but may invest depositors' money in relatively risk-free investments and give them a share of the profits, are supposed to be safer because of Islam's curbs on speculation. But Dubai Bank, an Islamic institution, ran into such serious debt problems that the Dubai government had to arrange last month for it to be taken over by a conventional bank.

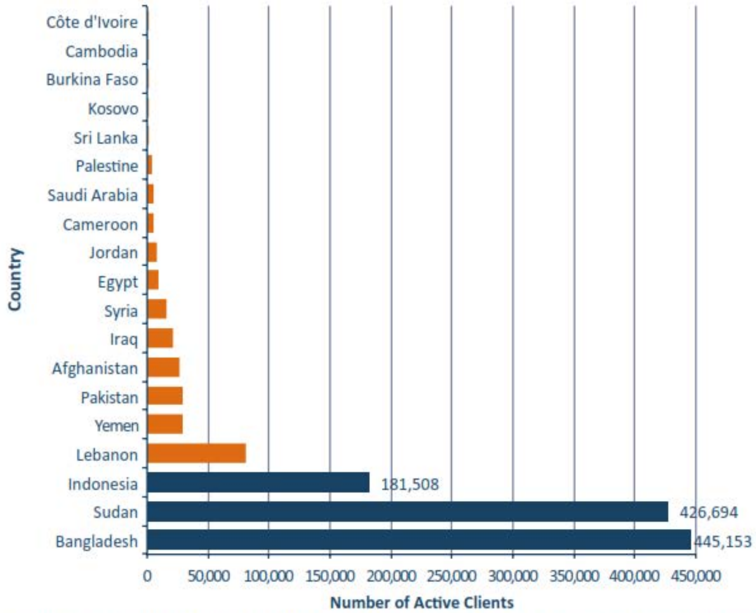
Access to the kingdom's debt market may appeal more to investors wanting to broaden their exposure than to those seeking yield, according to Doug Bitcon, a Dubai-based fund manager at Rasmala.

Shari'a- compliant financial products and instruments can play a significant role in enhancing financial inclusion among Muslim populations. About 700 million of the world's poor live in predominantly Muslim-populated countries. In recent years, there has been growing interest in Islamic finance as a tool to increase financial inclusion among Muslim populations (Mohieldin and others 2011).

The main issue relates to the fact that many Muslim-headed households and micro, small, and medium enterprises may voluntarily exclude them- selves from formal financial markets because of Shari'a requirements. Islamic legal systems, among other characteristics, prohibit predefined interest- bearing loans. They also require financial providers to share in the risks of the business activities for which they provide financial services (profit and loss sharing). Given these requirements, most conventional financial services are not relevant for religiously minded Muslim individuals and firms in need of financing.

But are these fears justified???

Figure 7. Number of Active Clients



Note: Data on Indonesia do not include BRI Syariah (BRI's Islamic finance subsidiary) or Islamic cooperatives, for which reliable data were unavailable.

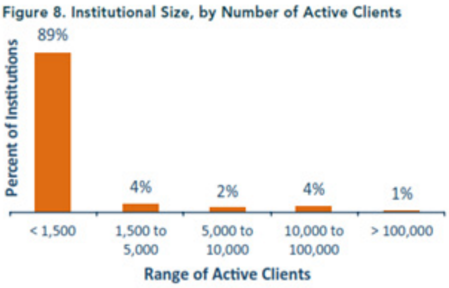
Based on a 2010 Gallup poll, about 90 percent of the adults residing in the Organization of Islamic Cooperation (OIC) member countries consider religion an important part of their daily lives (Crabtree 2010). This may help explain why only about 25 percent of adults in OIC member countries have an account in formal financial institutions, which is below the global average of about 50 percent. Also, while 18 percent of non-Muslim adults in the world have formal saving accounts, only 9 percent of Muslim adults have these accounts (Demirgüç-Kunt, Klapper, and Randall, forthcoming). Moreover, 4 percent of respondents without a formal account in non-OIC countries cite religious reasons for not having an account, compared with 7 percent in OIC countries (table B1.4.1) and 12 percent in the Middle East and North Africa.

For the second consecutive year, the Islamic Corporation for the Development of the Private Sector (ICD), the private sector development arm of the Islamic Development Bank (IDB), presents findings from the Islamic Finance Development Indicator, developed in collaboration with Thomson Reuters , the world's leading provider of intelligent information for businesses and professionals.

The ICD - Thomson Reuters Islamic Finance Development Indicator (IFDI) is the only numerical measure representing the overall health and development of the Islamic finance industry worldwide. It is an unbiased, multi-dimensional barometer that considers the development of the Islamic finance industry beyond mere asset growth. The IFDI measures five key components that combine to depict the bigger picture of the state of Islamic finance in 92 countries: quantitative development, governance, social responsibility, knowledge and awareness. The IFDI was first released at the Global Islamic Economy Summit (GIES) in November 2013 and will be updated annually.

Today, ICD and Thomson Reuters released findings for the Awareness Indicator which measures Islamic finance market awareness in 2013 by assessing three components: conferences, seminars and news for 92 countries.

Figure 8. Institutional Size, by Number of Active Clients



As a multilateral development institution, we have seen increasing interest from across our member countries for enabling Islamic finance architecture. The first step towards developing this architecture is enhancing the awareness of market participants and we are heartened with the sustained increase in news, seminars and conferences for Islamic finance. What is needed now for most of these emerging Islamic finance markets is to translate interest into action through the development of a holistic Islamic financial services framework that leads to a more inclusive financial system open for foreign direct investment. The rise in conferences and seminars points to a much higher number of delegates and participants reached worldwide

The number of Islamic finance conferences (>100 participants) worldwide surged by 41% to 107 in 2013 from 76 in 2012, with 36 countries hosting conferences compared to 25 in 2012. Seminars (<100 participants) also increased by 17% to reach 124 in 2013 from 106 in 2012, with 35 countries hosting seminars compared to 30 in 2012. The much higher growth in the number of conferences versus seminars - 41% v 17% - points to a bigger demand for industry interaction and engagement in 2013.

Malaysia, UAE, UK attract most conferences, intensifies battle to be world’s Islamic finance hub

In all, Malaysia played host to 22% of all conferences in 2013. The UAE comes in second with 11 followed by the UK (8) and Bahrain (6). The top three align with the contenders - Kuala Lumpur, Dubai and London - to be the world’s Islamic finance hub. Malaysia also leads on the number of seminars (28), followed by UK (19) and Oman (10).

Morocco and Tajikistan were noteworthy newcomers with four and three conferences respectively. Oman is taking serious steps to develop its Islamic finance industry by spreading awareness across the country through events such as seminars and conferences, and improved its ranking in the Top 10 for both.

New Non-Muslim countries host events, increasing recognition for Islamic finance outside the Muslim world

A clutch of new non-Muslim countries - Australia, Hong Kong, Philippines and Sri Lanka - join the UK as Islamic finance gains visibility and recognition outside the Muslim world. The UK's rise up the seminars sub-indicator is mostly driven by its government's ambition to become an Islamic finance hub, while Singapore, another top global financial centre, joins the UK as the only other non-Muslim-majority country in the Conferences Top 10 striving to increase its Islamic finance footprint.

Figure 9. Reasons for Not Having a Formal Financial Account (% Muslim Adults)

Source: Findex. The top bar marked "Not enough money to use (only)" reflects those respondents who only cited lack of funds as a reason for not having a formal account as opposed to those who gave that response as an explanation to a related reason, such as "not enough money to pay for transportation to the nearest bank" or "not enough money to afford transaction fees," etc.

Most of 2012's top ten countries retained their dominance in 2013, with the top four ranked countries - UAE, Malaysia, Saudi Arabia and Bahrain - remaining unchanged. In absolute numbers, Islamic finance news for 92 countries reached 14,500 in 2013. UAE is top for news focus, attracting almost 3,700 news reports. Malaysia trails with 3,300. The top two sweep almost 40% of global news. UAE leads primarily because of the year-long sustained media attention on Dubai's plans to become the world's capital of the Islamic economy; the announcement was made in January 2013 and news climax was reached in November at the GIES, which was also the highest point for Islamic finance news for the whole year. In Malaysia local press played an important role in reporting the country's developments, including big national news such as the introduction of the Islamic Financial Services Act 2013 which came into effect in July.

There is a wide gap between the top two leaders and third-placed Saudi Arabia which only attracted a little over 2,000 news pieces related to Islamic finance. For the other GCC countries exclusive country-level news as well as regional news lifted their rankings. Oman especially had an active year as several Islamic windows and banks started operations. This was followed by the conversion of a conventional insurance company to a takaful company, and the Sultanate's first-ever sukuk issuance in November.

UK topped European coverage. The country attracted a deluge of media focus when, as host for the World Islamic Economic Forum (WIEF) in London in October, the British Prime Minister announced the government's plans to issue the West's first sovereign sukuk.

It is a global level composite indicator with country and unit specific level indicators. The composite indicator is released annually, featuring a full report detailing each country and unit specific level indicator and their raw numbers.

Each indicator within the composite indicator's constituents will be equally weighted and aggregated, i.e. all variables are given the same weight. In addition, normalization is required prior to any data aggregation as the variable indicators in a data set have different measurement units.

For the Country Composite Indicator level, country indicators are normalized to allow for meaningful comparisons over time for a given country and between countries. Various economic indicators (e.g. population size) will be considered while measuring the health of the Islamic finance industry in each country.

Awareness Indicator is a weighted index of Islamic finance market awareness per country. It is measured by assessing three components: conferences, seminars and news. Awareness rationale was driven due to a consistent concern raised by professionals in the Islamic financial services industry that there is little awareness and understanding of Islamic financial services by the general public. Awareness by consumers can lead to better quality of services as consumers vote with their feet if the services offered are not up to par. If consumers have a low level of awareness about Islamic financial services, they cannot determine the quality of the services being offered, while the potential market base of customers interested about Islamic financial services will also be limited.

Muslim countries are far from uniform in terms of financial inclusion. For example, 34 percent of the unbanked Afghan population cite religious reasons for not having an account in a formal financial institution, while only 0.1 percent of Malaysians do so, although both countries have similarly high Gallup religiosity indexes (97 percent and 96 per- cent, respectively; see the Statistical Appendix).a This can be traced to the extent to which Islamic financial institutions are present in a given country. An analysis suggests that the size of Islamic assets per adult population is negatively correlated with the share of adults citing religious reasons for not having an account (table B1.4.2). This correlation is particularly strong if one focuses on the group of OIC countries and, even more, on those OIC countries that show a religiosity index exceeding 85 percent.

Based on the Global Findex, for religious reasons, some 51 million adults in the OIC countries do not have accounts in a formal financial institution b. Given that a majority of the OIC population lives in poverty, Islamic microfinance could be particularly attractive. For example, 49 percent and 54 percent of adults in Algeria and Morocco, respectively, prefer to use Islamic loans even if these loans are more

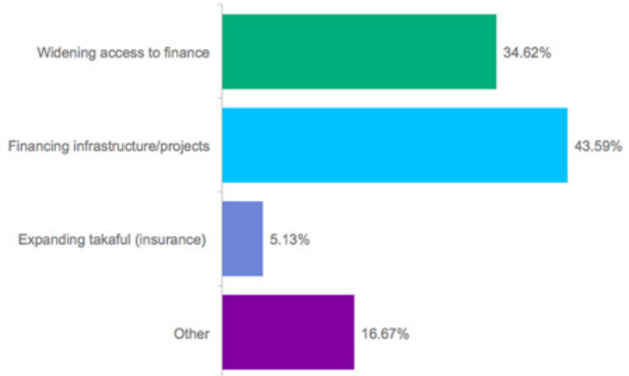
Within five years, these figures more than doubled, reaching 256 MFIs and 1.3 million active clients (El-Zoghbi and Tarazi 2013). These figures are on the conservative side because they are based on data for 16 of the 57 OIC member countries (excluding economies such as the Islamic Republic of Iran, Malaysia, and Turkey, which have active Islamic finance industries). In short, the estimated unmet demand for Shari'a- compliant financial products, in con- junction with the rapid growth of Islamic MFIs, as well as the astonishing growth of the overall Islamic finance industry, all point to the growing attractiveness of Shari'a-compliant financial products and the supply shortage of such products c.

Religiosity also has an impact on the access of firms to finance in OIC countries. The number of Islamic banks per 100,000 adults is negatively correlated with the proportion of firms identifying access to finance as a major constraint. The negative correlation is greater if one focuses on OIC countries and greater still if one focuses on a subset of OIC countries with a religiosity index above 85 percent (table B1.4.3). These findings, which are mainly driven by small firms (figure B1.4.1), suggest that increasing the number of Shari'a-compliant financial institutions can make a positive difference in the operations of small firms (0 –20 employees) in Muslim- populated countries by reducing the access barriers to formal financial services.

Efforts to increase financial inclusion in jurisdictions with Muslim populations thus require sustainable mechanisms to provide Shari'a-compliant financial services to all residents, especially the Muslim poor, estimated at around 700 million people who are living on less than $2 per day. One obstacle is the lack of transparency and the absence of a broadly accepted standard I zed process for assessing the compliance of financial institutions with Shari'a guidelines, which makes it difficult for many individuals to distinguish between financial institutions that are operating based on Shari'a specifications and institutions that are not. Another difficulty has been the lack of information and training on Islamic finance. For example, only about 48 percent of adults in Algeria, Egypt, Morocco, Tunisia, and the Republic of Yemen have heard about Islamic banks (Demirgüç-Kunt, Klapper, and Randall, forthcoming). Finally, in their infancy and smaller in scale, Islamic financial products tend to be more expensive than their conventional counterparts, reducing their attractiveness.

There is much potential for Islamic finance to promote sustainable economic development through such approaches as widening access to finance (including microfinance), financing infrastructure projects, and expanding the reach of takaful (Islamic insurance).

The best opportunity for Islamic finance to contribute to sustainable development lies in:



Contracts currently being used in Islamic finance are modified versions of classic nominate contracts found in Islamic commercial jurisprudence. It is, however, pertinent to note that classic contracts — such as those of sale and lease, which are widely used in Islamic commercial banking — were meant for trading, and these have been modified for financing in the modern banking environment. But over time, the practice of Islamic finance focused on Shari'a compliant debt at the micro (or transaction) level rather than moving away from interest-bearing loans at the macro (or system-wide) level. He clarified that avoiding interest-bearing loans does not automatically mean going for profit-and-loss-sharing arrangements. The mainstream view in Islamic finance industry is that debt created through a credit sale or operating lease, using the nominate contracts, does not fall within the scope of prohibition of riba.

Size and Composition of Industry

According to latest staistics data on domicile of Islamic banking assets show the following:

- Iran: 38%
- Saudi Arabia: 10%
- Malaysia: 10%
- United Arab Emirates: 7%
- Kuwait: 6%
- Qatar: 4%
- Others: 25%

He also shared breakdown of Islamic finance assets by the different segments. The data highlighted the fact that Islamic finance is best known for a fast pace of growth rather than size.

Region	Banking Assets		Sukuk Outstanding		Islamic Funds Assets		Takaful Contributions	
	US$ bln	Share	US$ bln	Share	US$ bln	Share	US$ bln	Share
Asia	192.30	15%	166.00	68%	19.30	26%	3.50	19%
GCC	490.30	38%	74.90	31%	35.90	49%	7.60	41%
MENA (ex GCC)	518.30	40%	1.20	0%	0.20	0%	7.10	39%
Sub-Saharan Africa	20.60	2%	2.20	1%	1.60	2%	0.20	1%
Others	62.20	5%	1.00	0%	16.70	23%	0.01	0%
Total	1,283.70	100%	245.30	100%	73.70	100%	18.40	100%

Sources: IFSB, Islamic Financial Services Industry Stability Report 2014 (forthcoming, data provided by KFH Research).

Commenting on the divergence between theory and practice, experts say that Islamic finance is meant to be inherently more ethical because of the sharing of risk by the contracting parties. In practice, however, instead of risk sharing, which is best accomplished by investment contracts, most of the financing is debt based.

Perhaps we are expecting too much from Islamic commercial banks, which currently account for most Islamic finance assets. Islamic finance is not meant to be confined to commercial banking, and there is more room for both existing and potentially innovative types of non-banking financial institutions. These non-bank institutions should not take deposits at the retail level and offer financing based on genuine risk–reward sharing to converge theory and practice.

If you take a purely legalistic view on Islamic finance, you can confine yourself to replicating commercial finance for the sole pursuit of profit. But Islamic finance is faith-based finance, and many expect it to also serve a social purpose and a role in sustainable economic development.

APPENDIX

Following are major Islamic bond issues in the global pipeline.

The Thomson Reuters Global Sukuk Index .TRUSDALL is at 113.99163 points, up from 113.54307 at the end of last month and 109.78969 at the end of last year. The Thomson Reuters Investment Grade Sukuk Index .TRUSDIG is at 111.52093 points, against 110.93472 at end-June and 107.28036 at the end of 2013.

PAKISTAN - The Pakistan government is looking to raise $1 billion from a U.S. dollar sukuk and plans to finalise arrangers within two weeks, a finance ministry official said on July 22. The government has shortlisted four banks and plans to launch the deal as early as September.

LUXEMBOURG - In early July, Luxembourg's parliament passed a bill that will allow the AAA-rated government to issue its first sukuk later this year; the bill lets Luxembourg securitise three government properties to back sukuk worth 200 million euros ($275 million).

SHARJAH - The emirate of Sharjah, part of the United Arab Emirates, is planning its first foray into international bond markets with a debut sukuk deal, bankers said in July; it is rumoured to have appointed banks to manage the transaction and could launch it as early as September.

HONG KONG - The Hong Kong government has mandated HSBC, Standard Chartered, CIMB and National Bank of Abu Dhabi for its first Islamic bond issue, sources close to the deal said; it is expected to occur in September. The sukuk are expected to be between $500 million and $1 billion and have a tenor of five years.

AQUASAR - Malaysia's Aquasar Capital will open bookbuilding on a multi-tranche, ringgit-denominated sukuk in the week of July 6 via sole lead RHB Investment Bank, bankers said; the issuer hopes to raise up to 1.5 billion ringgit ($468 million) for Sarawak State's sewerage system.

ADIRA DINAMIKA - Indonesia's PT Adira Dinamika Multi Finance ADMF.JK plans to raise at least 500 billion rupiah ($42 million) with ringgit-denominated sukuk in Malaysia by the end of the year, bankers said.

BUMI ARMADA - Four Malaysian banks are providing a 1.5 billion ringgit unrated sukuk facility for Malaysian oil field services firm Bumi Armada BUAB.KL, sources said in late June. Terms are being finalised; the deal will be privately placed.

K-ELECTRIC - Karachi-based utility K-Electric KELE.KA plans to raise as much as 22 billion rupees ($223 million) through sukuk to refinance existing debt, the company said in late June.

LIBYA - Libya's central bank is proposing to issue Islamic bonds to help fund the country's budget and offset a loss of oil revenues that could create a deficit of $25 billion this year, a bank official said in June.

KENYA - Kenya plans to issue another international bond and may consider a debut sukuk issue, the finance minister said in late June, after a successful debut $2 billion eurobond closed.

BANK MUAMALAT - Malaysia's Bank Muamalat BUKHCM.UL, a unit of sovereign fund Khazanah and auto-to-property conglomerate DRB-Hicom Bhd DRBM.KL, will raise up to 2 billion ringgit with Islamic bonds, credit agency Malaysian Rating Corp said in late June.

DOGUS - Dogus Varlik Kiralama, an asset leasing company, applied in late June to the Capital Markets Board to issue Turkey's first corporate Islamic bond. The sukuk would be worth up to $400 million and sold in the international markets.

BAHRI - National Shipping Co of Saudi Arabia (Bahri) 4030.SE plans to arrange long-term sharia-compliant financing in the next year to replace a bridge loan backing its $1.3 billion acquisition of Saudi Aramco's marine unit, Bahri said in June. Banking sources prebiously told Reuters Bahri was looking at a potential debut sukuk issue to replace the bridge loan.

SOCIETE GENERALE - Societe Generale SOGN.PA completed the roadshow for the first issue in its 1 billion ringgit multi-currency sukuk programme in Malaysia, and would decide on the size in days, the bank said on June 18. In early July, banking sources said Societe Generale was still seeking a window to launch.

IFC - The International Finance Corp, the World Bank's lender to the private sector, is considering a return to the Islamic bond market, an IFC official said. A sukuk issue is still in the early stages of discussion but would likely be in the fiscal year starting in July 2014.

JORDAN - Jordan's government is studying a proposal to issue its first Islamic bond as early as next year, possibly raising over $1 billion in multiple currencies, but a preference for concessionary loans from aid donor countries could hinder the plan, government sources said.

MALAYSIAN RESOURCES CORP - Malaysian Resources Corp MYRS.KL, a local construction firm, said on June 12 it would issue Islamic bonds to raise up to 680 million ringgit for land acquisitions and working capital.

AKTIF BANK - A special purpose vehicle of Turkish lender Aktif Yatirim Bankasi [CALIKB.UL} said on June 6 it would issue up to 200 million lira ($96 million) of sukuk. It did not give details.

RAS AL-KHAIMAH - The emirate of Ras al-Khaimah, part of the UAE, has invited banks to pitch for arranger roles on a potential dollar-denominated sukuk, sources said in early June. A deal isn't expected until at least the third quarter of this year.

BOTM - Bank of Tokyo-Mitsubishi UFJ 8306.T said on June 5 it was seeking to raise as much as $500 million through a multi-currency Islamic bond programme in Malaysia, becoming the first Japanese bank to use sukuk for fund-raising.

UEM SUNRISE - Malaysian property developer UEM Sunrise UMSB.KL has mandated CIMB and Maybank to lead a potential issuance off a 2 billion ringgit sukuk programme; bookbuilding is likely to kick off over the next couple of weeks after the borrower and its leads sound out investors, bankers said in early June.

BANGLADESH - The central bank is seeking to amend rules on its existing sukuk programme to broaden its use and allow for sovereign issuance by the government, a central bank spokesman said in June.

BANK ISLAM - Malaysia's Bank Islam plans to raise 1 billion ringgit by selling Islamic bonds to fund organic growth as well as a potential acquisition in Indonesia, two people involved told Reuters in early June. A 300 million ringgit Basel-III compliant Tier 2 sukuk is awaiting approval from the central bank and the Securities Commission for issue in July.

AL OTHAIM - Saudi Arabia's Al Othaim Real Estate and Investment Co, owner of five shopping malls in the kingdom, plans to issue its debut local currency sukuk as early as in June, sources aware of the matter said at the start of the month. The transaction is likely to be worth between 500 million and 1 billion riyals ($133-267 million), one of the sources added.

INDONESIA - Indonesia mandated HSBC HSBA.L, Standard Chartered STAN.L and CIMB Group CIMB.KL to arrange a sovereign sukuk issue of up to $1.5 billion, sources aware of the matter told Reuters on May 26.

AL BARAKA - Bahrain-based Al Baraka Banking Group BARKA.BH said in mid-May that it was considering issuing subordinated Islamic bonds through its South African and Pakistani units to boost their regulatory capital.

TUNISIA - Tunisia will sell its first sovereign Islamic bond in September after months of delays, raising $140 million, its finance minister said in mid-May. The ministry had previously planned a $500 million sukuk and gave no reason for the reduction in size.

IDB - The Islamic Development Bank plans to issue a benchmark-sized sukuk around May next year, close in size to a $1.5 billion, five-year sukuk which it issued in February this year, president Ahmad Mohamed Ali said.

In February, a senior executive said the IDB also aimed to issue its first short-term sukuk this year.

JEDDAH ECONOMIC CO - Saudi Arabia's Jeddah Economic Co said in mid-May it was in talks with local banks to raise funds for the 14 billion riyal first phase of its Kingdom City project. For part of the money, "we are looking at the bonds and sukuk market but this will need a structure in place, which we are working on," chief executive Mounib Hammoud said.

IOI PROPERTIES - Kuala Lumpur-listed IOI Properties IOIP.KL is considering an offer of Islamic bonds; it is looking to raise up to 750 million ringgit off a 1.5 billion ringgit sukuk programme, the company said in early May.

BANK MUSCAT - Bank Muscat BMAO.OM plans a dual-currency U.S. dollar and rial sukuk issue worth around $300 million that would be the first sukuk sale by an Omani bank. The issue, which could carry tenors of three to five years, would be part of a 500 million rial ($1.3 billion) sukuk programme which shareholders approved in March, Sulaiman Al Harthy, group general manager of Meethaq, Bank Muscat's Islamic operation, told Reuters in early May.

PELABURAN MARA - Malaysia's Pelaburan MARA, the investment arm of Majlis Amanah Rakyat, plans to issue sukuk worth up to 1 billion ringgit this year or next to finance its investments in the oil and gas and technology sectors, group chief executive Nazim Rahman was quoted as saying in April by The Edge Financial Daily.

HUA YANG - Malaysian property development firm Hua Yang Bhd HUAY.KL said on April 29 it had won approval from the securities commission to raise up to 250 million ringgit with an Islamic bond programme.

GULF FINANCE HOUSE - Bahrain-based Gulf Finance House GFHB.BH said on April 15 it had obtained shareholder approval to issue sukuk or arrange new debt facilities worth up to $500 million to restructure liabilities, develop projects and fund possible acquisitions; no time frame was given.

SABAH - Malaysia's Sabah Credit Corp, a unit of the Sabah state government, will raise up to 1.5 billion ringgit in musharaka sukuk, RAM Ratings said on April 7.

OMAN - Omani central bank executive president Hamood Sangour al-Zadjali said in March that the government would probably make its first sovereign sukuk issue at the end of this year.

FIRST GULF BANK - Abu Dhabi's First Gulf Bank FGB.AD, the third-largest bank by assets in the United Arab Emirates, plans to raise up to 3.5 billion ringgit with Islamic bonds in Malaysia, RAM Ratings said in March.

SOUTH AFRICA - The South African Treasury said in February that it was confident of issuing its first sukuk in the coming few months.

KILER REIT - Turkish real estate investment trust Kiler GYO KLGYO.IS plans to issue a five-year sukuk worth at least $100 million in the second half of this year, parent company Kiler Holding's chief financial Officer Kaan Aytogu said in February.

BANK ASYA - Turkish Islamic lender Bank Asya ASYAB.IS said in January that it was planning sukuk issues worth $500 million and 800 million lira this year, dependent on obtaining regulatory approval.

ACWA - Last December, Saudi Arabia-based water and power project developer ACWA Power said it had raised a 1.77 billion riyal Islamic loan from four local banks to help finance investments including acquisitions and act as a bridge to a sukuk issue in 2014.

ADB - The Asian Development Bank said in December that it was considering an Islamic bond issue as early as in 2014.