

Challenges of Islamic Financial Market Development

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السوق
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الدولية



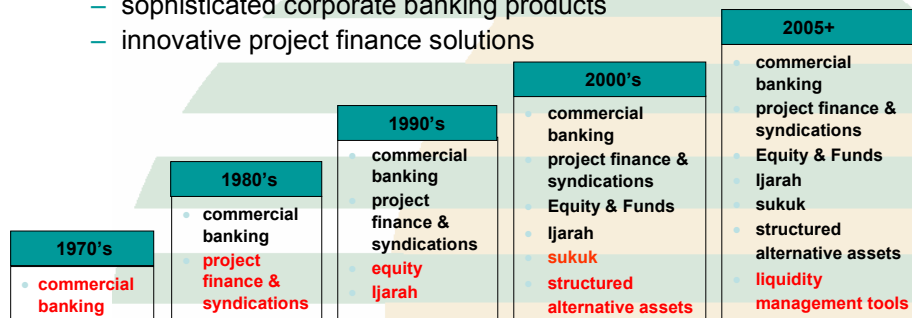
International
Islamic
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Market

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Evolution of the Islamic Finance Industry & Islamic Capital Markets

- Islamic finance has followed in the wake of innovations in the global financial services industry
- A natural progression of the Islamic finance industry
 - competitive retail offerings
 - sophisticated corporate banking products
 - innovative project finance solutions



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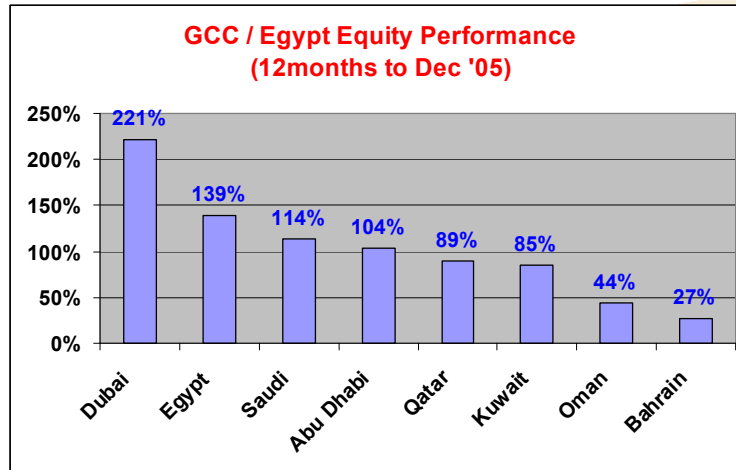
Global Market Perspective

- US Equity Market US\$ 12.7 trillion (46% Global)
- Global Equity Market US\$ 27.0 trillion (estimate)
- Islamic Equities @ 30%: **US\$ 8.0 trillion** Potential
- Islamic Financial Assets US\$ 400 billion (UAE MOF)
- Islamic Money Market US\$ 30 – 50 billion

US REITs	MARKET CAPITALIZATION (USD BIL.)	
	Component Number	Full
DJW REIT	93	252.8

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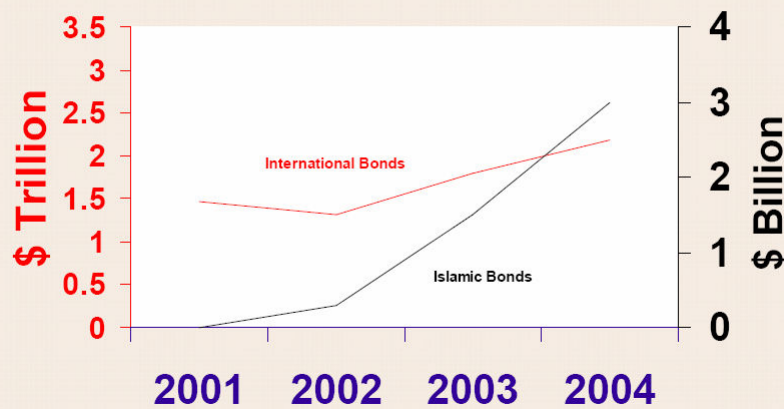
GCC Equities – 12 month Performance



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Global Bond Issues

New Issuance Levels 2001-2004

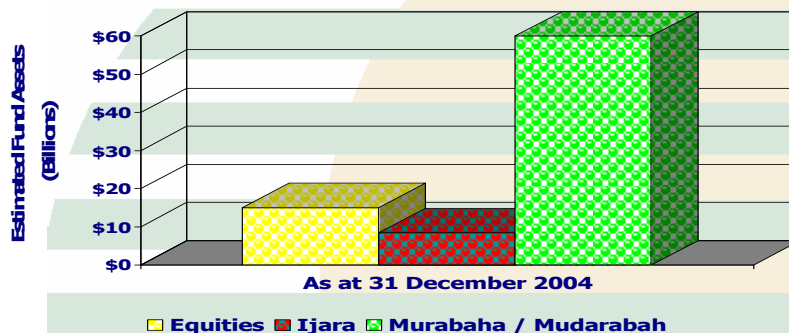


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Islamic Fund Management

- Islamic financial assets estimated at USD 400bn*
- Liquid assets estimated at USD 30-50bn **
- Islamic Fund Management c. 15% of sector liquid assets
- Access needs to be regulated and liquid capital market

(* source – UAE MOF/IMF)



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Current State of the Islamic Capital Markets

Conventional Instrument	Characteristics	Shariah-Compliant Alternative
Equity	Equity holders are the owners of the firm and responsible for conducting its affairs	Accepted
Preferred Stock-	A hybrid security that combines features of debt and equity	-
Primes and Scores	Equity is split into a prime component that has dividend and capital gains up to a stated price and a score component that has capital gains above this	-
Warrants	A long-term call option on a firm's stock issued by the firm	-
Synthetics	Securities that allow combinations of assets to be obtained with low transaction costs	-
Acceptances	A written promise to pay a given sum at a pre-specified date	Developed, but not negotiable
Commercial Paper	A short-term debt security that can be easily traded	Developed, but not negotiable
Bonds	A term obligation to make a series of fixed payments.	Emerging
Floating-rate Bonds	The interest rate on the debt is based on LIBOR or the T-bill rate	

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Current State of the Islamic Capital Markets

Conventional Instrument	Characteristics	Shariah-Compliant Alternative
Securitized loans	Pools of mortgages or other types of loans that are publicly traded	Emerging
Index-linked securities	Bonds where the payment is linked to an inflation index or a commodity price	Emerging
Convertibles	A bond that can be swapped for equity at a pre-specified ratio or vice versa	-
Swaps	Transactions in which different streams of income are exchanged	-
Options	The right to buy or sell a security on or before a specified date	-
Commodity futures Financial futures ⁹	Contracts for the future delivery of a commodity. Contracts for the future delivery of currencies, securities, or an amount of money based on an index.	Under development

Growing Sukuk investment opportunities

- **More issuers are seeking to tap the Sukuk market**
 - Increasing Demand for Sukuk issues among issuers from Muslim countries as well as other jurisdictions
 - Islamic financial institutions are seeking to diversify their portfolio and increase their portfolio size of tradable instruments with fixed income profile
 - *Sukuk* can be used to create Sukuk funds for retail distribution
 - Once Sukuk Fund concept become more popular demand for Sukuk issues will surge exponentially
 - Sukuk can be developed into a Money Market instrument
- **Appetite for Sukuk among Reserve Managers and non-bank financial institutions increasing**
 - Central banks, state fund managers, insurance & takaful companies, are keen to invest in Sukuk issues as seen in all the sovereign sukuk issues.
 - It is important to have tradable fixed income instruments for portfolio diversification
 - Sukuk can play a major role in the development of Islamic Inter-Bank or Short term Islamic Financial market

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Sukuk - Regulatory, Legal, Shariah & Other Issues

- Lack of regulatory support from key Islamic markets
- Lack of initiative in developing a separate legal framework for sukuk vis-à-vis conventional instruments
- Lack of harmonization in existing Islamic securitization products and difference of opinions among various shariah scholars
- Substantially more documentation and legal due diligence requirement for an Islamic issue
- Limited number of qualified personnel well versed in capital market issues both from shariah and commercial perspective
- Small number of Islamic investment banks lacking capability in structuring, originating or arranging capital market transactions

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Islamic Liquidity Management – Challenges

- Islamic transactions generally pass through the ownership of real assets.
- Prohibited to invest in interest-bearing instruments
- Inability to trade money as commodity
- Lack of variable tenor tradable instruments
- Insufficient generation of quality assets
- Islamic banks, reliant, mostly on balance sheet assets for liquidity management
- Sub-optimal deployment of excess liquidity
- Risk Management techniques

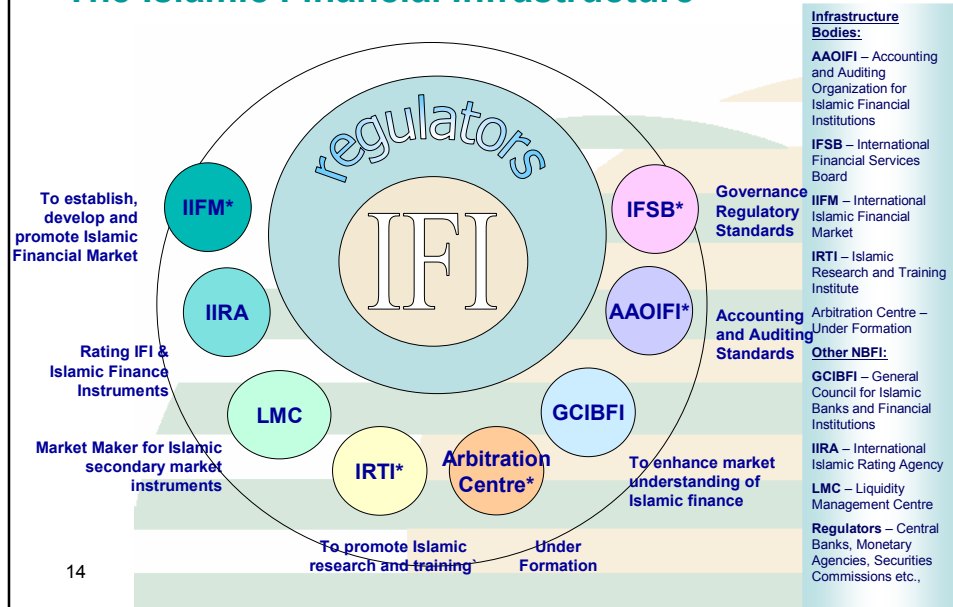
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Islamic Liquidity Management – Potential Role

- The fixed income market will be a developed market for Liquidity management when
 - There are issuers with differing credit qualities and Risk profile
 - There are Sukuk with maturities ranging from short-term to long-term
 - The investor base is broadened (via diversification of Sukuk products) to facilitate participation of more investors
 - Infrastructure and IT
- Market Makers & Brokers
 - Well defined role of Lead arrangers
 - To provide bid-offer prices on a continuous basis
 - Role of infrastructure institutions especially IIFM, LMC
 - Need for market development bodies

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The Islamic Financial Infrastructure



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Recommendations for Way Forward

- Establishment of a Regulatory Framework
- Skilled Human Resource
- Short term Islamic Financial Market
- Liquidity Enhancement Measures
- Product Development
- Islamic Sukuk Index
- Required infrastructure as available to conventional market
- Development of Shariah Compliant Asset Backed Securities

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Recommendations for Way Forward Contd.

- Active secondary market
- Uniformity of structuring and documentation
- Financial support to research and development and educational institutions
- Diversification of financial instruments and encouraging research on product development
- Increase number of Shari'ah scholars well versed in Finance and Banking issues
- Organizing conferences and seminars focusing on secondary market issues

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Conclusion

For the Islamic Finance Industry to grow, move forward and capitalize on the enormous growth potentials, there should be:

- Greater cooperation among the industry players
- Better coordination to address the issue of Shari'ah harmonization
- Urgent need for the structuring of new capital market products that are Shari'ah compliant
- Creation of International Sukuk Fund

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Thank You

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