

3RD IFSB INNOVATION FORUM 2021

Digital Transformation of the Islamic Finance Industry

The 3rd IFSB Innovation Forum focus on technological innovations that create a competitive edge for the Islamic financial services industry in the digital era and its contribution to furthering the growth of Islamic finance while identifying potential regulatory and supervisory considerations arising from such practices.

TABLE OF CONTENTS

02

*Opening Remarks
Dr. Bello Lawal Danbatta,
Secretary-General, IFSB*

**3RD IFSB INNOVATION
FORUM - DIGITAL
TRANSFORMATION OF
THE ISLAMIC FINANCE
INDUSTRY: INDUSTRY
CASE STUDIES**

03

*Session Summary by
Dr Rifki Ismal,
Assistant Secretary-
General, IFSB*

03

*Dr. Zamir Iqbal,
Vice President,
Finance and Chief
Financial Officer,
Islamic Development
Bank (IsDB)*

05

*Dr. Yahia Abdul-Rahman,
Chairman and Chief
Executive Officer, LARIBA
Bank of Whittier*

06

*Dr. Hilal Hussain,
Team Leader
(Knowledge Solutions),
Islamic Development
Bank Institute (IsDB
Institute)*

ISLAMIC FINTECH SYMPOSIUM

The
symposium
provides a
survey of the
Saudi FinTech
landscape and
showcases
two Saudi
FinTechs.

08

*Mr. Nezar A. Alhaider,
Fintech Hub Manager,
Fintech Saudi*

09

*Mr. Abdulaziz Alsayyari,
Founder and Board
Member of Sukuk
Capital*

12

*Mr. Osama Alraee,
Co-Founder and
CEO of Lendo*

OPENING REMARKS



The future of the Islamic financial services industry depends on the ability to keep up with the latest developments, understand the value of innovation and adapt to external factors, such as shifting customer preferences and competition from fintech and big tech market entrants, as well as internal factors by harnessing the potential of digital technologies.

In his opening, Dr. Bello Lawal Danbatta, Secretary-General of the Islamic Financial Services Board (IFSB), recalled that the Pre-Summit event of the 15th IFSB Summit is an essential platform for the IFSB members and non-members to exchange ideas and share Islamic finance initiatives and experiences to support the growth of a sound and stable Islamic financial services industry. It is part of the IFSB's mandate to create a platform for cooperation among its members that will promote the development of Islamic finance and strengthen the global resilience of the Islamic finance industry.

The IFSB Innovation Forum is a bi-annual event to cultivate innovative thinking and dialogue and foster the development of an efficient, competitive, sound and innovative Islamic financial services industry in a rapidly changing global environment. The focus is on technological innovations that create a competitive edge for the Islamic financial services industry in the digital era and its contribution to furthering the growth of Islamic finance while identifying potential regulatory and supervisory considerations arising from such practices.

Recent global events have resulted in a vastly accelerated pace of change and transformation in the financial services industry, spurred by the need for digital connectivity to replace physical interactions between consumers and financial service providers. Globally, the pandemic has hastened the shift to digital payments and increased the share of consumers using digital channels and products. The future of the Islamic financial services industry depends on the ability to keep up with the latest developments, understand the value of innovation and adapt to external factors, such as shifting customer preferences and competition from fintech and big tech market entrants, as well as internal factors by harnessing the potential of digital technologies.

Innovations in the provision of financial services present a need to adapt regulatory frameworks and supervisory practices that consider the specificities of Islamic finance and a need to rethink the scope of regulatory perimeters to consider the growing diversity of financial service providers and business models. Adapting regulatory frameworks can also present certain trade-offs between different policy goals. To balance competing policy objectives, authorities need to increase collaboration at the national and international levels. Sharing expertise between national authorities on financial regulation of new entrants and incumbents in the IFSI and coordinating policy actions across jurisdictions is essential, particularly given the potential for cross-border spill-overs such as cybercrime prevention and data governance decisions, to mention a few. Collaboration can also help peer learning between jurisdictions and help establish regulatory consistency, strengthened by the implementation of international standards of best practice.

This forum allows dialogue with policymakers and industry players leading the way in innovation in the Islamic financial sector.

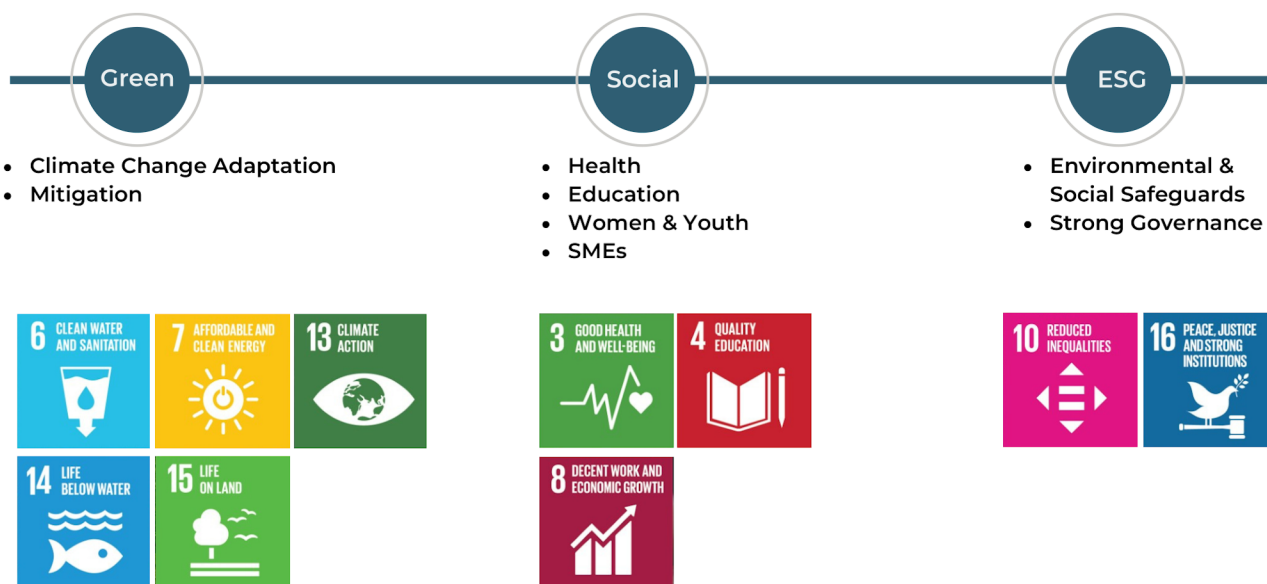
3RD IFSB INNOVATION FORUM - DIGITAL TRANSFORMATION OF THE ISLAMIC FINANCE INDUSTRY: INDUSTRY CASE STUDIES

Session Summary

The session was moderated by Dr. Rifki Ismal, Assistant Secretary-General, IFSB. He introduced the topic of the Innovation Forum: Digital Transformation of the Islamic Finance Industry – Industry Case Studies. Digital transformation is gaining momentum, and the IsDB Group has initiated various programmes, projects, and research related to digital technologies and sustainable finance. Two presentations will highlight these activities. While digital transformation is largely a technical process, it occurs in financial institutions interacting with people. A practice report from an Islamic bank in a non-Muslim country illustrates how digital technologies can be applied without giving up the human factor.

Dr. Zamir Iqbal, Vice President, Finance and Chief Financial Officer, Islamic Development Bank (IsDB), stressed that sustainability is embedded in all of its work since the IsDB is a multilateral development bank. The IsDB is a signatory of the Sustainable Development Goals (SDGs) and is very active in achieving those goals by itself and in its member countries. From the wide range of activities of the IsDB, the initiative for mobilising resources through the so-called labelled sukūk is of particular interest in the context of this summit.

Sustainability in IsDB



When the IsDB considered options for widening the investor base for its sukūk issuances, a growing class of investors came into focus, who are very particular about how the money raised by a bond or sukūk issuance is used. These so-called ESG investors are very concerned about the environment, sustainability, and governance. To diversify its funding sources and tap into the growing pool of green investors, IsDB developed its Sustainable Finance Framework in 2019. It serves as the foundation to issue green, social and sustainability sukūk.

The issuance of green sukūk has to consider the principles of green and sustainable finance that have evolved over the last 20 years into a kind of global standard. The IsDB managed - after a very rigorous exercise - to get its framework rated by one of the top rating agencies in this area (CICERO A.S. from Norway) as medium green shade, which is considered very good by green investors. It is the same shade given to the KfW, IFC, African Development Bank, and others.



Sustainable Finance Framework

- Outlined the eligible criteria in line with international standards and the Sustainable Development Goals.
- Commitment to allocate sukūk proceeds to assets as per the theme (Green, Social, etc.)
- Verification by external party for independent assessment



Second Party Opinion (SPO)

- External verification by CICERO AS (Norway)
- Conference calls for detailed explanation on the framework
- Secure a 'Medium-Green' Shading, which is same as our peers such as IFC, AfDB, KfW



ESG Risk Rating

- External verification of IsDB ESG credentials by Sustainalytics
- Extensive process of risk and Assessment of Governance practices

After that rating, IsDB was able to issue one green sukūk and two sustainability sukūk within the Sustainability Finance Framework. The first-ever AAA-rated green sukūk raised EUR 1 billion in 2019, the first-ever AAA-rated sustainability sukūk raised USD 1.5 billion in 2020, and the largest-ever sustainability sukūk raised USD 2.5 billion in 2021 – in total more than USD 5 billion.

ESG investors are very keen to monitor the progress of their financed projects. The IsDB is committed to producing an annual report on what development indicators have been achieved, for example, how much emissions have been reduced or how many jobs have been created for the youth and women. The IsDB has recently published the first impact report on its green sukūk. It shows which projects were (co-)financed by the sukūk and their impact results in various categories. Digitalisation was a great help in this context. During the Covid-19 pandemic, it was impossible to go out and inspect projects. The IsDB started to work with virtual reality technologies developed by Amazon and Microsoft that facilitate monitoring without physical presence. Through digital tools like sensors or drones, it is possible to see the progress of projects, for instance, how well crops are growing or how effective the water supply and distribution systems are functioning in remote areas.

Digitalisation has extreme potential here. When the basic infrastructure is provided, it is possible to monitor projects quickly, efficiently, and repeatedly to ensure they are on track. With timely information and continuous progress monitoring through digital technologies, the IsDB Bank has become attractive for even more ESG investors. The technology is available on the market and could also be used by other Islamic financial institutions that could tap into different investor classes and provide green and sustainable project financing.

Dr. Yahia Abdul-Rahman, Chairman and Chief Executive Officer, LARIBA Bank of Whittier, briefly summarised the evolution of the LARIBA financial institutions in the United States. LARIBA American Finance House started 34 years ago with only USD 200,000 and has grown into an important force in the mortgage market. It is licensed as a non-depository institution by the California Department of Corporations. In 1998, a full-service national bank - the Bank of Whittier – was bought, which grew its capital to USD 20 million, its assets to USD 175 million, and the loan portfolio to USD 600 million. All the assets are from the community. The bank is supervised by the Office of the Comptroller of the Currency (OCC) in the Department of the Treasury of the United States federal government. Bank of America has injected capital and now owns 4.9% of the bank. All Citibank ATMs recognise Bank of Whittier's ATM cards in the United States.

Islamic banking is a movement to benefit people in need, Muslims and non-Muslims. Ribā-free bankers are out there to make their life better and easier. That is why a ribā-free bank is not a mega-bank but a community bank. It is crucial to involve people, not keep people away from the bank. Ribā-free banking has to be banking for community development, i.e., investing in the community to generate economic prosperity. Ribā-free credit must be different from loans, especially credit card lending. Ribā-free bankers must go on a mission as community bankers to replace credit card lending with ribā-free financing.

Conventional banks use very sophisticated ATMs that do everything a teller does. They use these machines because they do not want customers in their costly branches. Digitalisation keeps customers away from the bank. That is exactly the opposite of what ribā-free banking is about. The ribā-free banker should involve customers, educate them, consult them, and counsel them to live better lives. The small investors in a community need to be cared for, not the affluent.

Digital technologies can also support the ribā-free approach. LARIBA uses the same advanced digital technology for internet banking as Bank of America, Chase and Citibank but applies it with a different goal and objective. The Bank of Whittier has a simple-to-use website to open an account and apply for a mortgage and business or commercial financing. However, nothing is executed without the final approval of a person.

Wise-FinTech Banking at Bank of Whittier

التقنيات المالية الحكيمة التي نستخدمها



Internet Banking Using Same Core Processor as BofA, Chase and Citibank

نستخدم نفس المؤسسات الحاسوبية المتخصصة في خدمة المصارف الكبرى مثل سيتي بانك و تشيس

Simple to Use Web Site to: Apply to Open Account, Mortgages, Commercial and Non-Profit Organizations

نستخدم التقنيات المالية في جمع المعلومات مع بقاء التواصل مع العميل و لايمكن ان تفتح حساب او علاقة مصرفية دون البحث و التقصى و موافقة المسؤولين

The whole idea of ribā-free banking is interaction with people. The ribā-free banker needs to know who the customer is: he needs to talk to the customer and the customer's spouse; he needs to know how many children they have, etc. The ribā-free banker needs to know everything about the customers to bring them into the ribā-free family. It is about touching people's hearts, minds, and pockets. Wisely used FinTech attracts and engages customers. Ribā-free banking must involve the human factor.

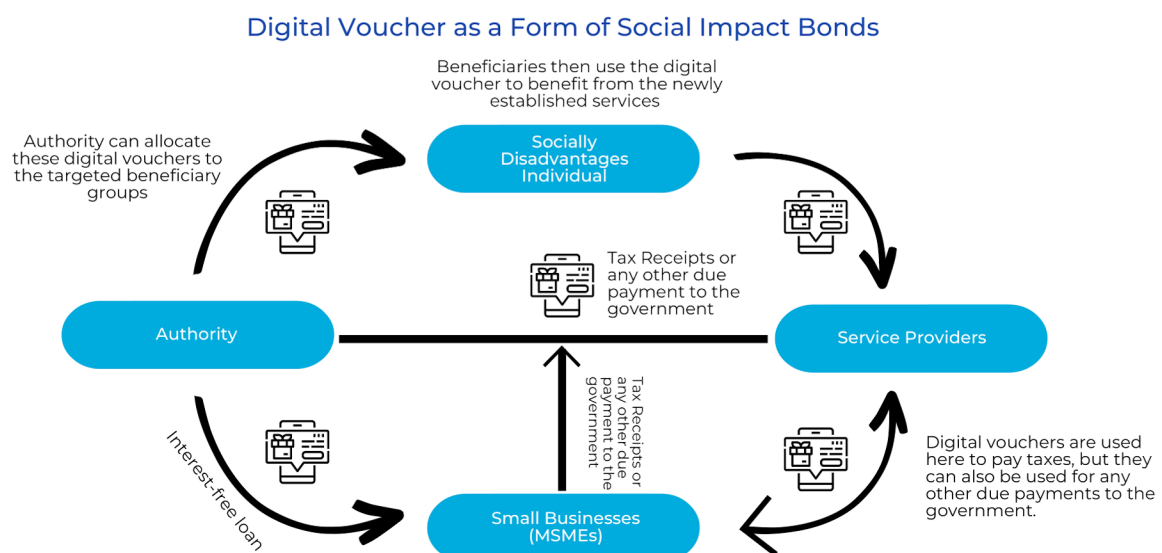
Ribā-free banking is a new banking discipline presented in the United States as an alternative. LARIBA hires young men and women who graduated from college and teaches them ribā-free banking from scratch. The candidates must be top students, and they are trained by a senior person who is a ribā-free executive. LARIBA employs people from all faiths and backgrounds to generate a new movement that will change the banking industry

Dr. Hilal Hussain, Team Leader (Knowledge Solutions), Islamic Development Bank Institute (IsDB Institute), explained a model of digital vouchers as a form of social impact bonds. The IsDB Institute developed the model as complementary money for stimulating economies and enhancing inclusion, and it has been patented in Singapore.

Digital vouchers represent a digital value that can be anything, including money. Vouchers are built on blockchain technology – secure, traceable, and transparent. The model comprises three stakeholders: an authority, beneficiaries, and service providers. The authority could be a governmental or non-governmental non-profit entity responsible for managing voucher circulation. The beneficiaries are target groups that shall be supported. There are mainly two groups: socially disadvantaged individuals and micro and small enterprises (MSMEs). Individuals could get the vouchers as grants, while small businesses may get them as interest-free loans. The service providers are businesses that offer various kinds of goods or services, e.g. supermarkets, pharmacies, clinics, electronics stores, restaurants, or gas stations.

Instead of real money, the authority issues vouchers and allocates them to beneficiaries who can purchase goods and newly established services from the service providers and pay by digital vouchers. The service providers can redeem the vouchers, use them to pay taxes or purchase materials and equipment from the small businesses (MSMEs) participating in the voucher scheme. MSMEs can purchase from service providers or pay taxes or bills from government utilities with vouchers. When the beneficiaries are MSMEs, they can expand their capacities and provide new services that vouchers can buy. The effect will be a stimulation of the economy.

If vouchers can be used to pay taxes or for other due payments to the public sector, the government has to be part of the scheme.



Digital vouchers differ from a central bank digital currency (CBDC). The CBDC is a formal currency issued by the central bank, while digital vouchers are complimentary money. The government needs not to print extra money to push forward the network of beneficiaries, service providers, and small businesses. The objective of digital vouchers is to promote financial inclusion, while the main objective of the CBDC is financial stability. The authority issuing digital vouchers could be any developmental agency CBDC can only be issued by the central bank. Digital vouchers are strictly domestic, CBDC is exchangeable for foreign currencies. Digital vouchers do not require reserves, while CBDC does. The digital vouchers require decentralised ledger technology (blockchain), while CBDC could also use centralised technologies.

Digital Voucher vs Central Bank Digital Currency

	Digital Voucher	CBDC
Status	Complementary Currency	Formal Currency
Objective	Inclusion	Stability
Authority	Development Agency	Central Bank
Exchange	Strictly Domestic	Exchangeable for Foreign Currencies

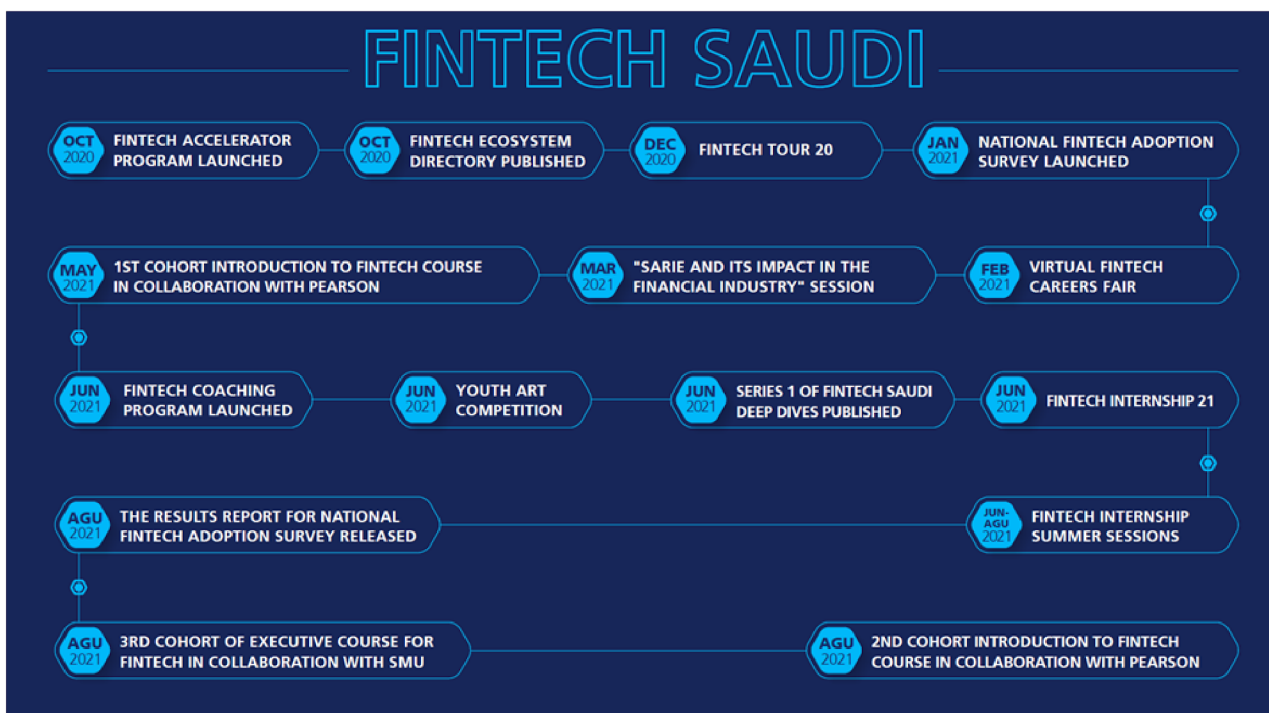
Blockchain technology with cryptography-based security can assure that security and privacy are taken care of. For the IsDB Institute, the validation of Shari‘ah compliance is of prime importance. The IsDB Institute would validate and track compliance in time and detail for transactions recorded on the blockchain.

ISLAMIC FINTECH SYMPOSIUM

The symposium provides a survey of the Saudi FinTech landscape and showcases two Saudi FinTechs.

Session Summary

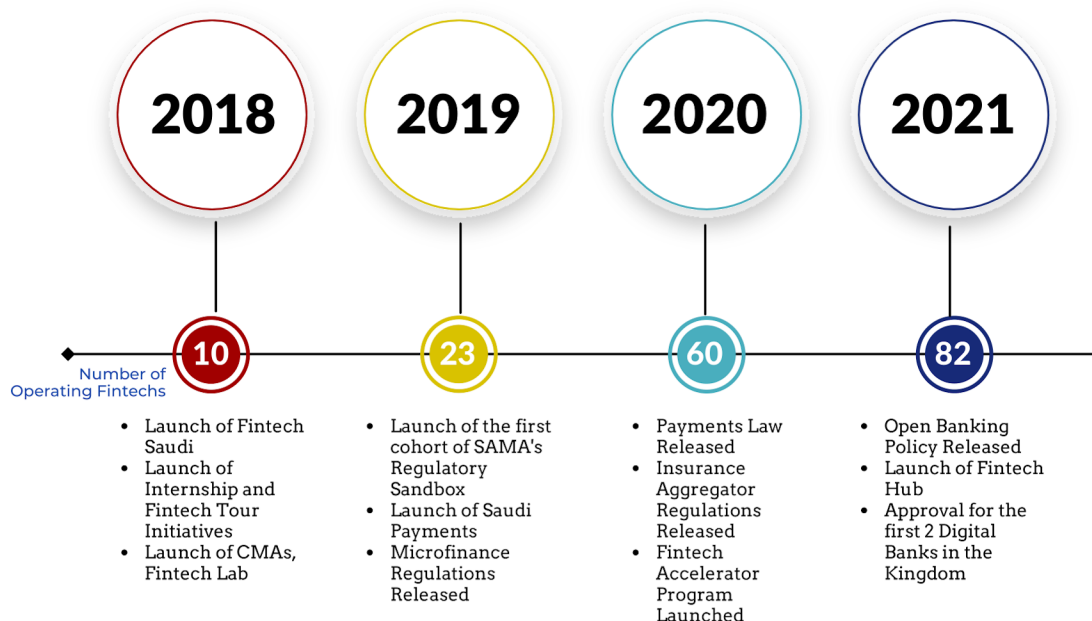
Mr. Nezar A. Alhaider, Fintech Hub Manager, Fintech Saudi, informed that FinTech Saudi, was established jointly by the Saudi Central Bank (SAMA) and the Capital Markets Authority (CMA). Fintech Saudi develops an enabling ecosystem to position the Kingdom as a regional FinTech hub.



Fintech Industry in Saudi



Fintech Industry Evolution



Saudi Arabia has more than 82 operating FinTechs in various verticals, particularly financing, lending, payments, and the capital market. Investments in the ecosystem by angel investors, VCs, and capital arms of banks are growing. The regulator is flexible and develops directives experimentally through a sandbox to find the most suitable Saudi market regulations. Accordingly, SAMA has started to issue licenses for payments, crowdfunding, and insurance aggregation. The launch of an instant payment system (SARIE) by SAMA enables small FinTechs to expand in the payments market. Most FinTechs are presently in the payments vertical.

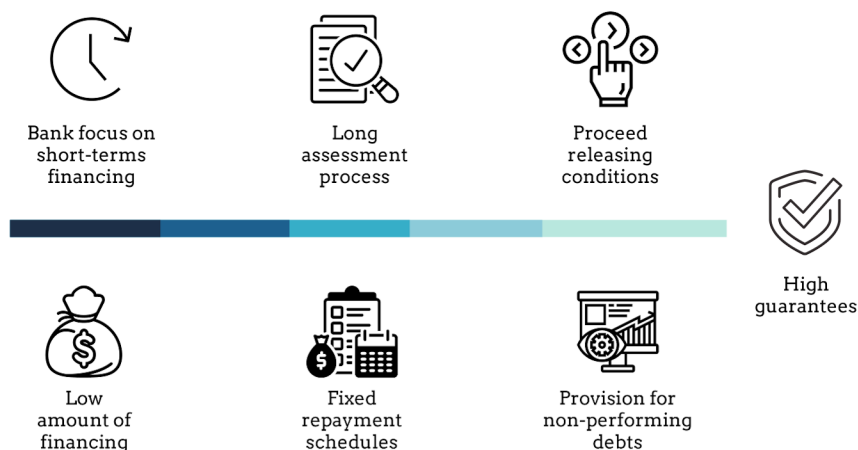
Fintech Database by Industry Vertical



The announced launch of open banking will pave the way for the next wave of FinTechs in the Saudi market. The industry has also seen a growing technological engagement by incumbents: banks partnering with FinTechs, banks outsourcing certain functions to FinTechs, banks investing in FinTechs, and banks setting up a fund purely dedicated to FinTech investments.

Mr. Abdulaziz Alsayyari, Founder and Board Member of Sukuk Capital, discussed the problems of SMEs with long-term debt financing through banks. Banks focus on short-term debt because most of their assets are short-term, and they must observe Basel III ratios for risk-weighted assets. If they consider a long-term loan, project assessments could take many months, high guarantees are required, less than the full amount is provided, and repayment schedules are inflexible.

Debt Financing Challenges



Sukuk Capital provides an alternative with a financing offer within three days, a flexible repayment schedule of up to 10 years, full Shari‘ah compliance, compliance with AAOIFI, a fully electronic process, and amounts up to SAR 30 million (approx. USD 8 million).



Sukuk Capital was licensed by FinTech Lab of CMA in November 2020 and started operations with the first sukūk issuance for a hospital in Saudi Arabia in May 2021. By October 2021, SAR 200 million in sukūk were issued, with 100% repayments on time.

Sukuk Capital targets companies with a turnover from SAR1 0 million to SAR 500 million. Most of these companies do not get financing from banks because banks consider SMEs too risky.

Sukuk Capital applies a fully electronic sukūk issuance process integrated with government entities in Saudi Arabia and other data providers. The application is very user-friendly. After registering and uploading the needed documents, the team of Sukuk Capital will do the credit assessment and give a sukūk issuance offer in less than 24 hours. Without any compromises on the quality of due diligence, the possible links with digital databases in Saudi Arabia facilitate the automation of many tasks, such as compliance or legal work, which have become very fast. Sukuk Capital receives financial data from electronic databases that can be analysed automatically. The internal credit system analyses more than 500 data at once for decisions on acceptance and pricing, and third parties and credit experts verify it. Digital technologies help respond and give financing offers in such a short time.



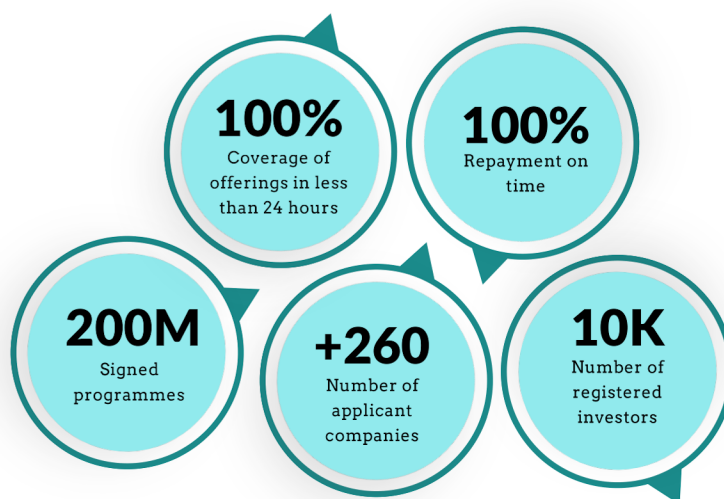
Full-electronic Process

A full-electronic Sukuk Issuance Process. Sukuk System is linked to many government agencies and companies. We are linked to more than 12 service and data providers.

After the issuance offer is accepted, the sukūk issuance agreement is signed, a special purpose entity is established, and the sukūk is offered to the investors. A Shari‘ah committee monitors all processes and operations and ensures AAOIFI standards are observed. More than 10,000 investors are registered, and 260 companies apply for sukūk issuance.

Sukūk in Numbers

Sukuk Capital uses two standardised structures for sukūk issuances: murābahah for short-term debt up to 5 years and ijārah for long-term debt up to 10 years. The difference is that ijārah is linked to an asset, while murābahah is based on debt issuance.



Financing Structure

A financing programme with a value up to 80% of the project cost is approved. It is disbursed during the project phases. The asset of each amount is paid at a different year.

Structure of Instruments	Ijārah	Murābahah
Period	Up to 10 years	Up to 5 years
Financing Amount	Up to 30 million SR	Up to 30 million SR
Financing Uses	Construction and equipping of expansion buildings	Construction, equipping of expansion buildings and working capital
Profit Margin	Starting from 6% annually	
Profit Payment	In payments	
Financing Payment Amount	Paid at the end of financing period	
Guarantee	Personal guarantee / assets mortgage	Personal guarantee

Mr. Osama Alraee, Co-Founder and CEO of Lendo[1], portrays Lendo as a Saudi FinTech company for Islamic financing, licensed by the Saudi Central Bank, that provides invoice financing to SMEs through a crowdfunding platform. Lendo finances a volume of more than SAR 150 million with an average closing time of three minutes per financing.

There was a financing gap for SMEs of SAR 500 billion in 2019 that will grow to SAR 800 billion in the next five years. Vision 2030 sets the target to increase the contribution of SMEs to the GDP from 20% now to 35% by 2030 and take SME lending from 4% of all commercial lending in 2019 to 20% by 2030.

SMEs have only limited sources of funding in Saudi Arabia. With a decreasing number of national banks through mergers and acquisitions – from 12 to 10 – and few non-banking financing institutions that focus on SMEs, they approach shadow markets to cover their capital needs. On the other hand, investors look for short-term investment opportunities with great returns and reasonable risk.

Problem



Lendo has been in the sandbox for the last two years and got great support from FinTech Saudi and the Saudi Central Bank. The Lendo system was built from a white sheet, not burdened by legacy teams, processes, paper forms, et cetera. The objective was to design Islamic financing products that could be given within one hour.

Lendo finances invoices of SMEs to large enterprises or the government that are standing to get paid in 3 to 6 months. After due diligence, these invoices are presented on the Lendo platform, and any Saudi resident or institution can finance these invoices. This is done through an automated process with the integration of many government agencies such as the Bayan Credit Bureau, the Ministry of Justice to issue promissory notes, the Ministry of the Interior for KYC, and many other service providers. The availability of APIs for connecting to databases and systems was crucial for the system. With this information, Lendo does not need audited financials to do the underwriting. It was not a clear model from day one. It took two years to build it.

[1] This Saudi FinTech (<https://lendo.sa>) should not be confused with a marketplace for loans that was established under the same name in 2007 in Sweden (<https://www.lendo.group/about-lendo/>).



Highly Reliable Scoring Engine

Integrated with the highly credible SIMAH and Bayan Credit Bureau in addition to government entities like MCI, our sophisticated scoring engine uses a number of data points to understand the hazards associated with each investment.

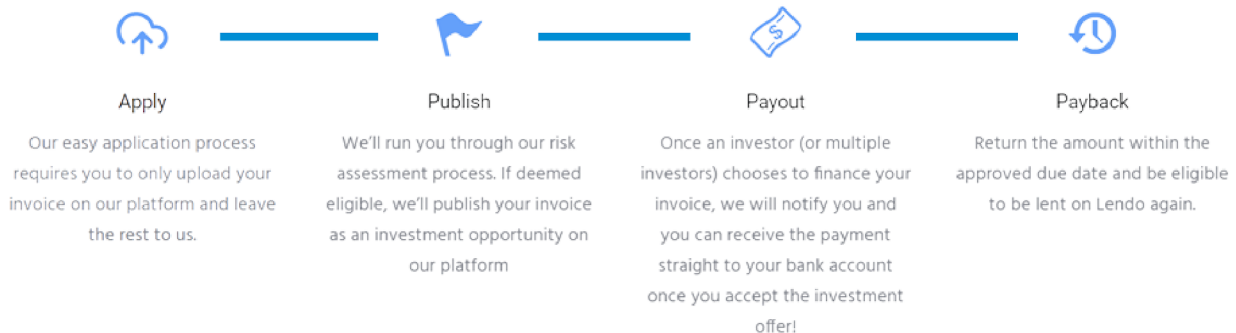
Every SME that applies for invoice financing must go through our risk assessment process. Only the ones that we approve are displayed on our platform as an opportunity for investors to pick and choose.

Our scoring engine displays each investment opportunity with a risk band (A,B,C,D) which provides you insights into the level of risk attached with the opportunity. It is completely up to you to decide which funding requests you want to invest in.

The short closing time of minutes is important because the financing period is 3 to 6 months. If the underwriting process takes weeks, the loan will no longer be needed. Time is critical, and speed is essential in short-term business. Digitalisation has made processes much faster without compromising on risk. Being fast is a competitive advantage and allows for optimising costs and growing the business.

How it works?

Get Liquidity from Lendo in simple, quick steps:



Finance Up to % 80% <small>of invoice principal amount</small>	Fund Value Up to 3 Million <small>Company Limit</small>	Swift Service ⌚ 3 Days <small>or Less</small>	Rate Starting at 📈 0.8% <small>Per Month</small>
--	---	---	--

Lendo charges 1-3% management fees from the SMEs, a 20-30% success fee from the investor's profit once the money is collected, and in the future, a one-off registration fee for the SMEs when they apply for a loan. In 2021 Lendo financed more than SAR 150 million with 0% default in 300 opportunities, funded by more than 10,000 investors. The average annual return to the investors was 14%. Lendo plans to launch a few new products in 2022, e.g. reverse invoice financing (also called supply chain financing), point of sales financing, and e-commerce financing.

Solution



Since banks are not interested in small ticket sizes of SAR 50,000 because of their high operating costs, Lendo is not competing with them. On the contrary, banks can be a partner as marketplace financing needs financiers. These are currently individuals, but they could also be banks, government funds, non-banking financial institutions, insurance companies, et cetera. Institutional investors could become enablers for the growth of the platform. At present, SAR 200 million lending has been done with 10,000 investors, but that cannot be scaled up to SAR 5 billion from individual investors only. Institutional investors must come into play.

Lendo could be a model for other countries that prefer decentralised platforms for invoice financing over a centralised institution. A central platform would limit the choices for SMEs from where to get invoice financing. It would also harm creativity, innovation, and competition. The main advantage of a central solution is that there is one registry for financed invoices. A system of decentralised platforms has to find other solutions to ensure that the same invoice is not financed several times. In the GCC, credit bureaus could provide such a service.

We thank you for your continued support, productive deliberations, discussions, new insights and for your participation in the 3rd IFSB Innovation Forum.

Connect with Us



@islamicfinancialservicesboard
www.ifsb.org