

Challenges and opportunities in global Islamic finance industry stability

December 2019

Speakers Biographies



Henry MacNevin, who is based in London, is currently an Associate Managing Director responsible for bank ratings in the Middle-East, South-Eastern Europe and Turkey, and is also responsible for Moody's global Islamic Finance initiatives.

He was also previously responsible as Associate Managing Director for Moody's bank ratings in Italy and the CEE region and was the Country Manager for Moody's in Italy for several years.

Mr. MacNevin's previous banking experience includes seven years with the Barclays group, where he held positions in strategic planning, corporate banking, and credit risk management.

Henry MacNevin

Associate Managing Director,
Financial Institutions Group



Nitish Bhojnagarwala is a Vice President – Senior Credit Officer with Moody's Financial Institutions Group. Based in Dubai, Nitish covers a portfolio of large conventional as well as Islamic financial institutions in the Middle East, Africa and Turkey

Nitish joined Moody's in 2011, and has led sukuk roundtables and conducted workshops on Banking and Islamic finance at various conferences in the Middle East, Europe and Asia.

Prior to joining Moody's, Nitish spent five years at Tamweel in the Treasury function. He has also worked for KPMG in the UAE, where he covered financial institutions.

Nitish Bhojnagarwala

Vice President – Senior Credit Officer,
Financial Institutions Group

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Islamic Finance

Islamic Finance is an important part of global capital markets in view of the rising demand in the Middle East and Asia. The sector seeks to encourage investment and financing that conforms with the ethical and moral principles of the Islamic faith.



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Islamic financial institutions – Middle East: Blockchain will reduce cost and support broader adoption of sukuk, a credit positive for Islamic Finance industry

23 SEP 2019 | MOODY'S INVESTORS SERVICE
A new partnership to build the next generation of financial market infrastructure for Islamic capital markets based on blockchain aims to make sukuk more easily accessible and manageable.

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SECTOR IN-DEPTH

Islamic banking – Bangladesh: Legal and regulatory shortfalls, coupled with growing asset risks, will limit growth



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23 September 2019

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Islamic banking – Bangladesh
Legal and regulatory shortfalls, coupled with growing asset risks, will limit growth potential

Summary
Islamic banking in Bangladesh has ample growth potential, undermined by a robust domestic

CROSS-SECTOR

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SECTOR IN-DEPTH 12 March 2019

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Cross-Sector – Islamic Finance

GCC will drive growth in 2019; long-term prospects remain strong

The Islamic finance sector remains underrepresented in the global financial system and as such, maintains ample room to expand. We expect it to do so in the coming years as demand for Shari'ah-compliant financial instruments continues to rise. In 2018, Islamic banking penetration in the Gulf Cooperation Council (GCC), Malaysia, Indonesia and Turkey (core Islamic finance markets) increased to 30.5% as of September, from 25% in 2012, while annual global sukuk (bond) issuance increased to \$119 billion from \$80 billion. This year, globally we expect sukuk issuance to remain flat and the takaful (insurance) market to see stable growth as insurance premiums pick up in newly penetrated markets. We also expect stable growth in Islamic banking in most core Islamic markets.

- » **Islamic financing asset growth will remain stable and will continue to outpace conventional counterparts.** Underpinned by (1) sovereigns' continued strategic objective to grow the Islamic finance industry both domestically and globally and (2) continued demand for Islamic products by bank customers, particularly individuals. Mergers between Islamic and conventional banks in the GCC (where surviving entities are Islamic banks) could also drive one-off increases in assets in 2019 and 2020.
- » **Sukuk issuance will remain relatively flat around current high levels.** Sukuk issuance grew by 5% in 2018 to \$119 billion, following record-high growth of 31% in 2017 to \$113 billion. We expect issuance to amount to \$120-\$130 billion in 2019, supported by the higher deficit financing needs of some GCC sovereigns amid moderate oil prices and higher sukuk refinancing needs. Corporate issuance in asset-backed sukuk will remain limited because of more attractive conventional market opportunities. Nevertheless, sukuk issuance from these sectors could be a source of growth underpinning the industry's longer-term potential. The English court's ruling on the Dana Gas case upholding creditor's rights alleviated market concerns, which further supports the industry's outlook.

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10 April 2019

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Financial Institutions
UK Islamic banking: Evolution, opportunities and challenges

Summary
UK-based Islamic finance firms have established themselves as niche players in wealth management and retail banking over the last several decades. The sector is set for further growth thanks to government initiatives to promote financial inclusion, regulatory changes that have made it easier to issue Islamic bonds, or sukuk, in the UK. Islamic finance is also likely to increase its UK market penetration via a new generation of FinTechs, meeting the demands of an expanding Muslim population. However, the sector's prohibition of interest

TABLE OF CONTENTS
UK Islamic banks are mainly retail focused 2
UK Islamic banks benefit from multiple growth opportunities 5
UK authorities aim to address remaining challenges 7

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Islamic banking – CIS

Increasing government position the sector for rapid expansion

Summary

Islamic banking in Commonwealth of Independent States (CIS) countries remains underdeveloped, although the region has a large Muslim population. Governments, however, are stepping up efforts to develop the sector by laying out legal and regulatory infrastructure. This will lead to significant expansion of Islamic finance in the coming years, albeit from a very low base, building on the region's demographic and cultural foundation.

- » **Islamic banking will grow substantially in CIS countries as governments step up efforts to develop the sector.** Government support is critical for the development of Islamic banking because the business of providing Shari'ah-compliant financial services requires the establishment of comprehensive regulatory frameworks foremost. In addition, given that large public sectors historically have led the growth of economies and banking systems in the region, a government-led model will be particularly effective for CIS countries in expanding Islamic banking and increasing public awareness of the sector.
- » **Regulatory disadvantages, along with weak public awareness, are the biggest obstacles to Islamic banking growth.** Among other regulatory hurdles, in most CIS jurisdictions, asset purchases and resales, which are part of many standard Islamic finance transactions, are subject to value-added taxes, unless authorities grant an ad hoc exemption. Also, in some countries, including Kazakhstan, Islamic banks' deposits are not covered by state deposit insurance systems. Further, Islamic banks cannot use central banks' conventional liquidity and funding facilities because they all bear interest. These disadvantages result in higher funding and operating costs for Islamic banks than for mainstream lenders.
- » **Four CIS countries, led by Kazakhstan and Kyrgyzstan, will drive Islamic finance growth.** Despite the hurdles, Islamic finance in Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan is set to grow, thanks to government support and large Muslim populations. What differentiates them from other CIS countries the most is the level of government

Moody's Research

S. No	Publication Date	Report title	Market
1	19-Feb-19	Sovereign sukuk issuance to recover amid moderate oil prices and higher refinancing needs	Global
2	12-Mar-19	GCC will drive growth in 2019; long term prospects remain strong	Global
3	27-Mar-19	Qatar's launch of Energy bank is credit positive for Islamic finance sector	Qatar
4	1-Apr-19	Growing demand supports premium growth, driving regulatory improvement	Global
5	10-Apr-19	UK Islamic banking: Evolution, opportunities and challenges	UK
6	16-Apr-19	Egypt establishes a Shariah board to oversee sukuk issuance	Egypt
7	9-May-19	Corporate issuers drive strong global green bond volume in Q1 2019	Global
8	16-May-19	Boubyan Bank's rights issue is credit positive	Kuwait
9	16-May-19	Al Rayan's partnership with a mortgage broker is credit positive	EMEA
11	1-Jul-19	Islamic banking in Indonesia and Malaysia	Asia
10	15-Aug-19	Islamic banking in CIS	EMEA
12	26-Aug-19	H1 2019 Sukuk Update	Global
13	16-Sep-19	Africa: Robust performance and strong sukuk issuance support Islamic banking	Africa
14	17-Sep-19	GCC asset managers benefit from economic diversification, foreign investment	GCC
15	17-Sep-19	Saudi Arabia: Rising Demand and supportive regulation is driving Islamic penetration higher	GCC
16	17-Sep-19	Saudi Arabia: Insurer's weaker profitability and capitalisation pressures will spur M&A	GCC
17	19-Sep-19	Increased Islamic banking penetration supports Pakistani banks' profitability	Pakistan
18	23-Sep-19	Blockchain will reduce cost and support broader adoption of sukuks, a credit positive for Islamic Finance industry	GCC
19	30-Sep-19	Legal and regulatory shortfalls, coupled with growing asset risks, will limit growth	Bangladesh
20	28-Nov-19	Pilot fintech Sukuk credit positive for Islamic banks	GCC

Agenda

1. Six global themes and rating framework
2. Growth and sustainability of Islamic Finance in core markets
 - a) GCC, Malaysia, Indonesia & Turkey
3. Islamic Finance in frontier markets – opportunities
 - a) Bangladesh
 - b) CIS
 - c) UK
4. Key challenges for the sustainable development of Islamic Finance

1

Six global themes
and rating framework

Six themes will shape global credit in 2020

RECESSION RISKS

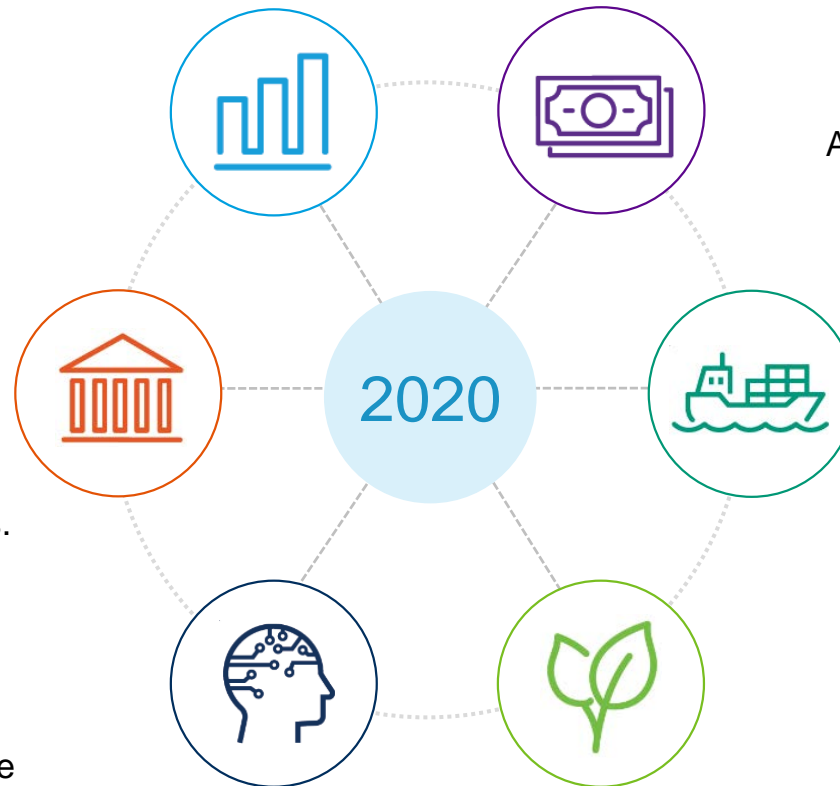
Recession risks will rise amid a pronounced global economic slowdown.

POLITICAL RISKS

Domestic policy shifts and geopolitical uncertainty will threaten to undermine credit conditions in many regions.

DISRUPTIVE TECHNOLOGIES

Scaling up of digital technologies will accelerate the transformation of traditional businesses.



LOWER-FOR-LONGER INTEREST RATES

An increasing share of assets globally will yield very low or negative interest rates.

TRADE TENSIONS

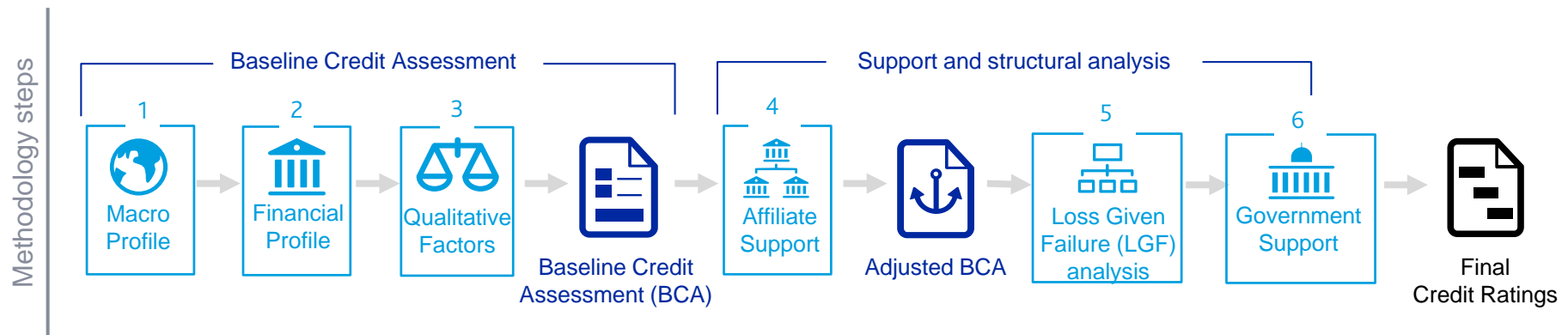
An enduring US-China trade deal will remain elusive and trade disputes will weigh on credit conditions.

ESG IMPACT

Climate risks will constrain the availability of capital for the most-exposed sectors; demographic and social trends will create risks and opportunities.

Moody's Bank Methodology Overview

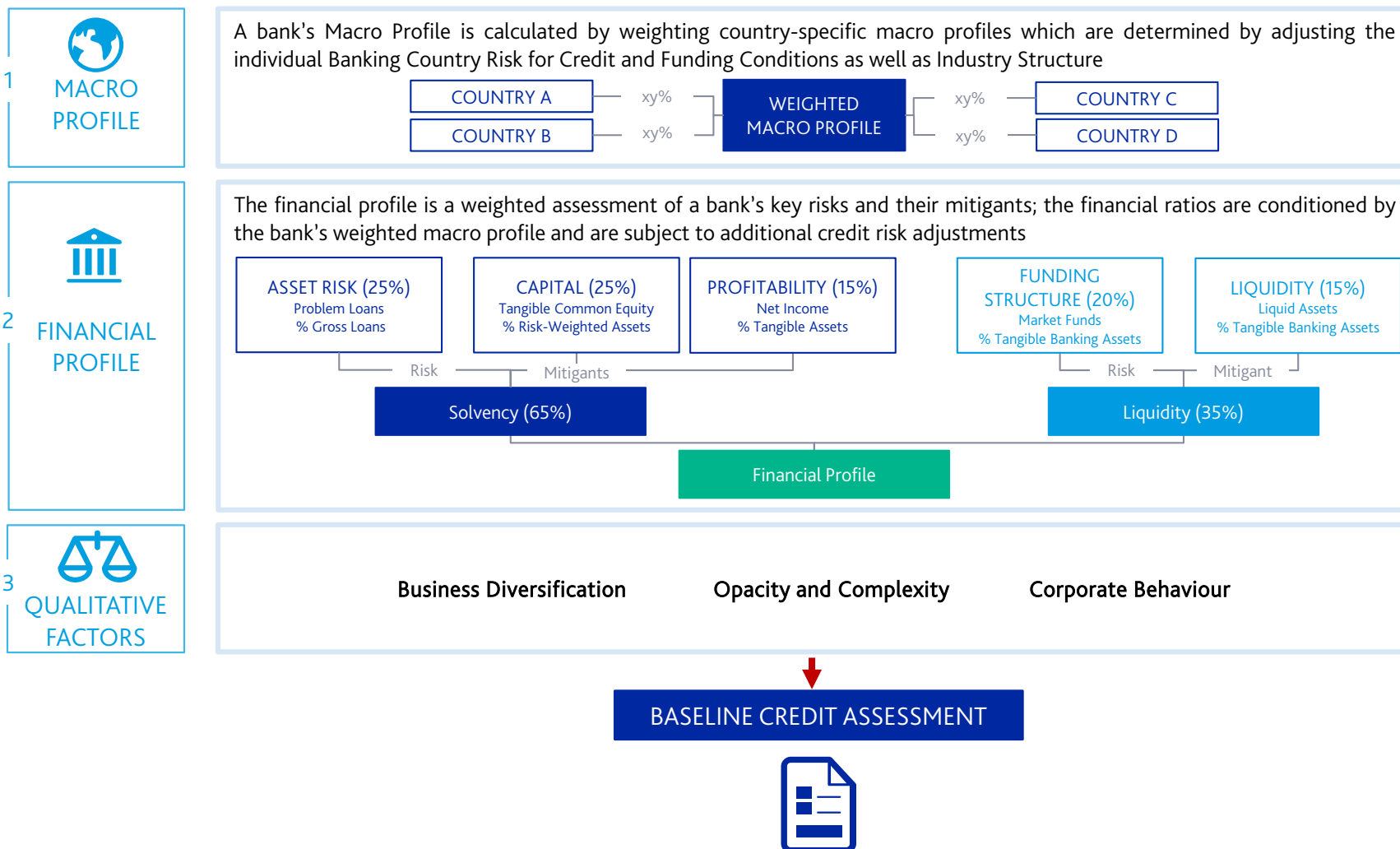
A sequential analysis taking into account a new form of “resolution” and generating ratings for each instrument class



Source: Moody's Investors Service

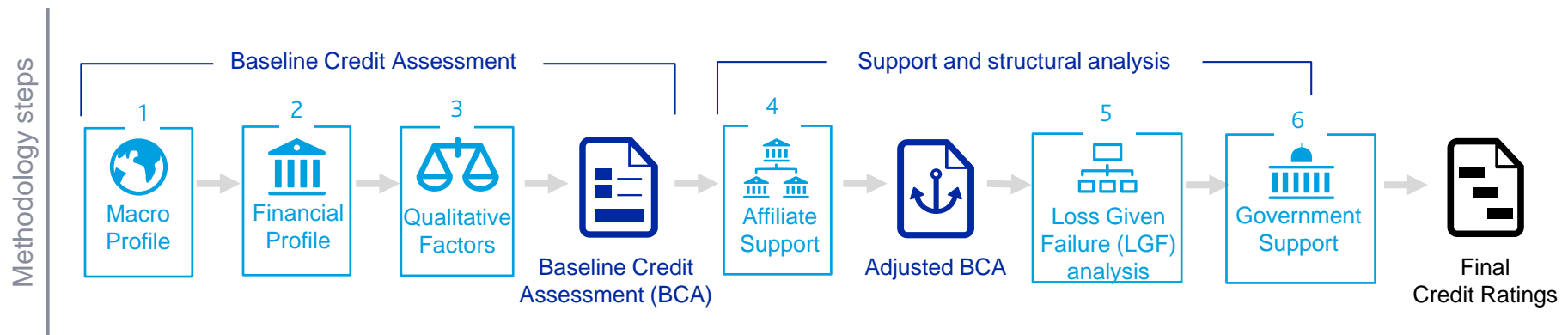
Baseline Credit Assessment (BCA) structure

Our Baseline Credit Assessment (BCA) speaks to a bank's stand-alone probability of default



Moody's Bank Methodology Overview

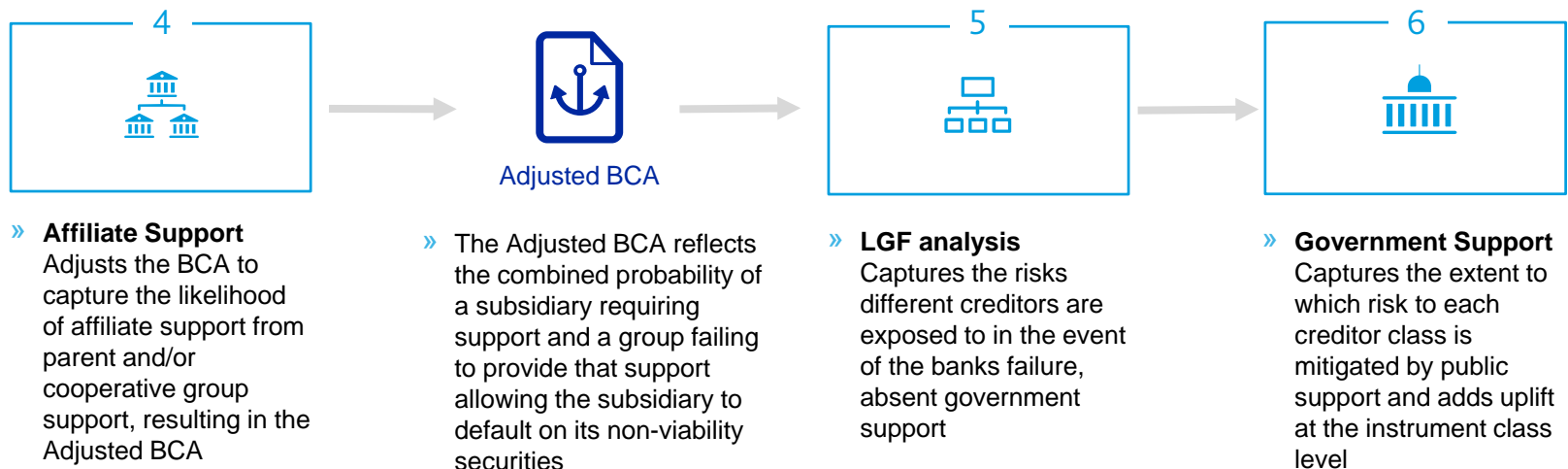
A sequential analysis taking into account a new form of “resolution” and generating ratings for each instrument class



Source: Moody's Investors Service

Support and structural analysis

Our final credit ratings reflect the expected loss of each creditor type mitigated by public support



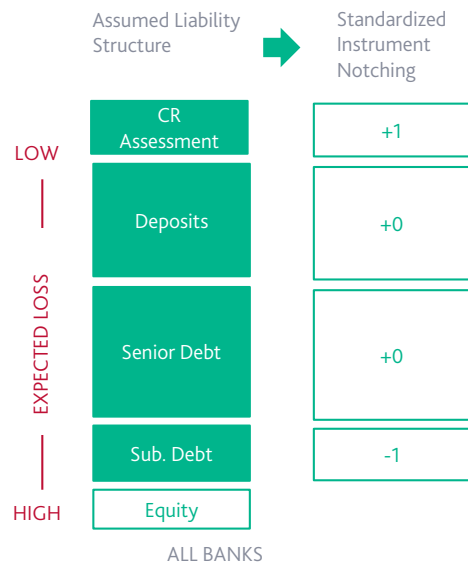
Source: Moody's Investors Service, Credit Opinion August 27, 2019

Support and structural analysis



5 BASIC LOSS GIVEN FAILURE ANALYSIS

The **EXPECTED LOSS** of each debt class is derived from a **standardised instrument notching for all non-ORR banks**



6 GOVERNMENT SUPPORT PRINCIPLES

- » **PROBABILITY OF SUPPORT** best reflects an instrument's importance to the public; support is significantly conditioned by the overall attitude of the relevant public bodies and any constraints they may face, beyond their own creditworthiness, in providing support
- » **CAPACITY TO PROVIDE SUPPORT** also includes contingent liability risk from the banking sector
- » **DEPENDENCE BETWEEN SUPPORT PROVIDER AND RECIPIENT** assesses the connection between the financial health of the government and the banking system based on sector size, level of stress in banking system and the economy, and ability to apply necessary support

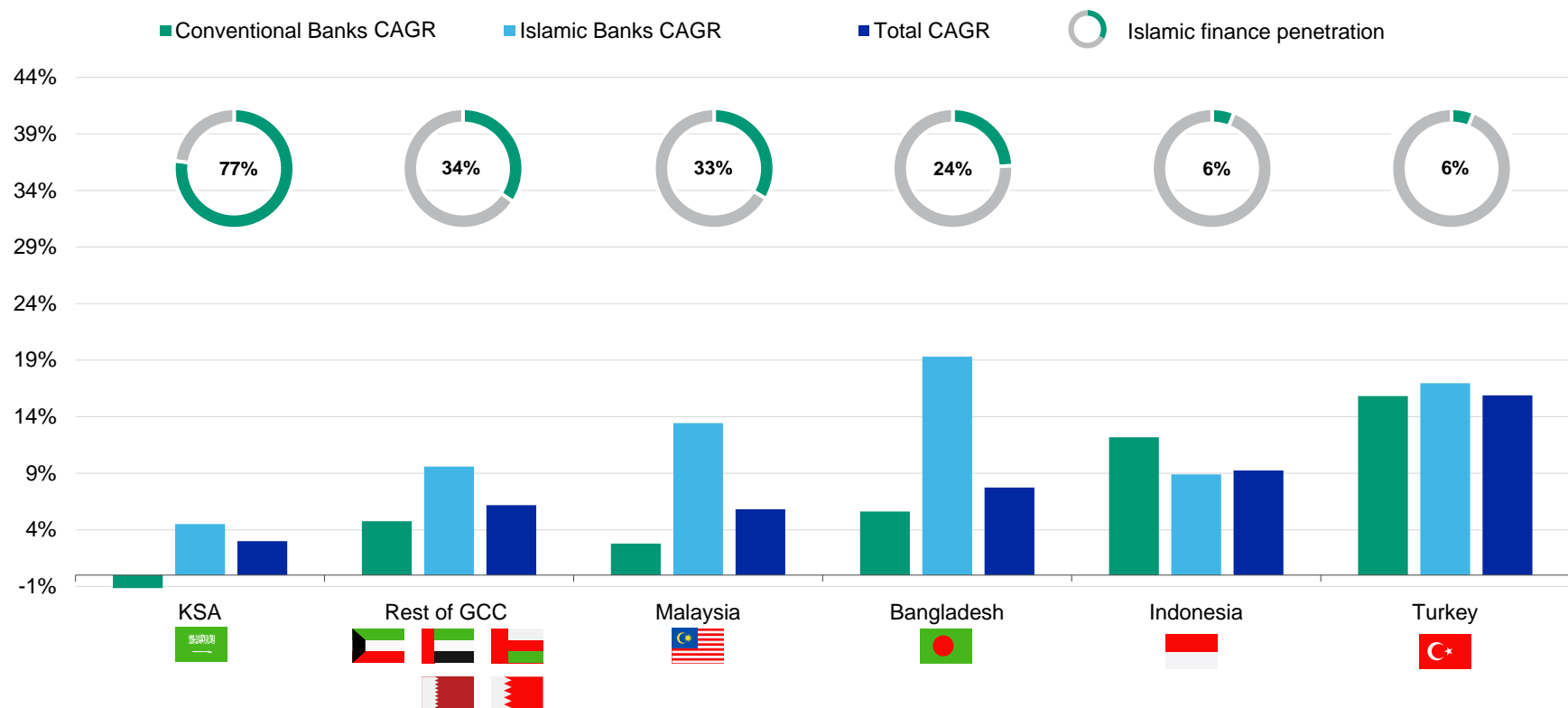
2

Growth and
sustainability of
Islamic Finance in
core markets

Islamic Finance market growth outperforms traditional finance industry

Growth - Islamic banks* vs conventional banks

Islamic financing as % of total financing

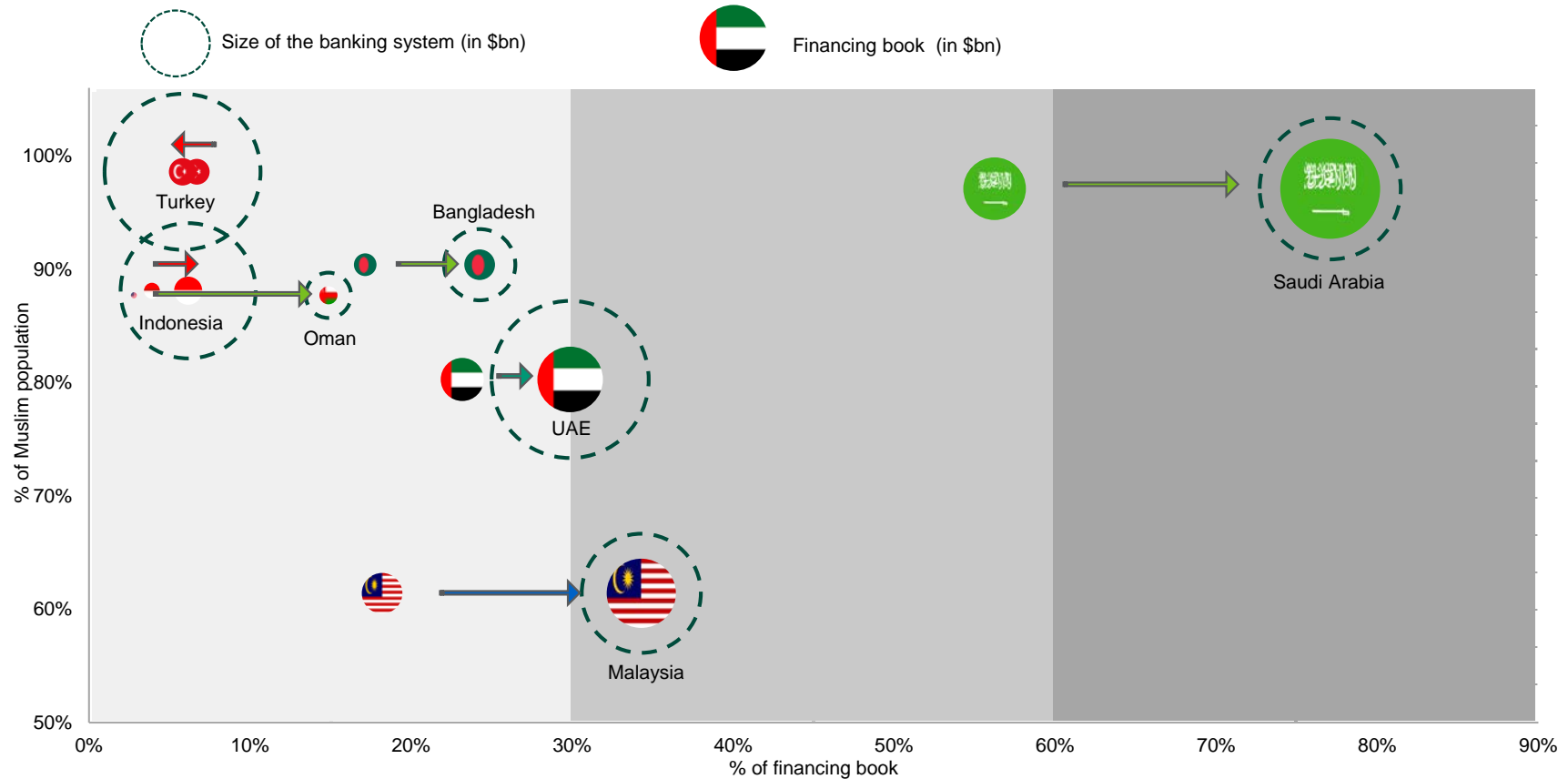


(*) This growth is for loan book

Sources: Central Bank data for Qatar, Bahrain, Oman, Malaysia, Turkey and Indonesia, Banks' annual reports

Turkey & Indonesia continues to underpin long term growth potential

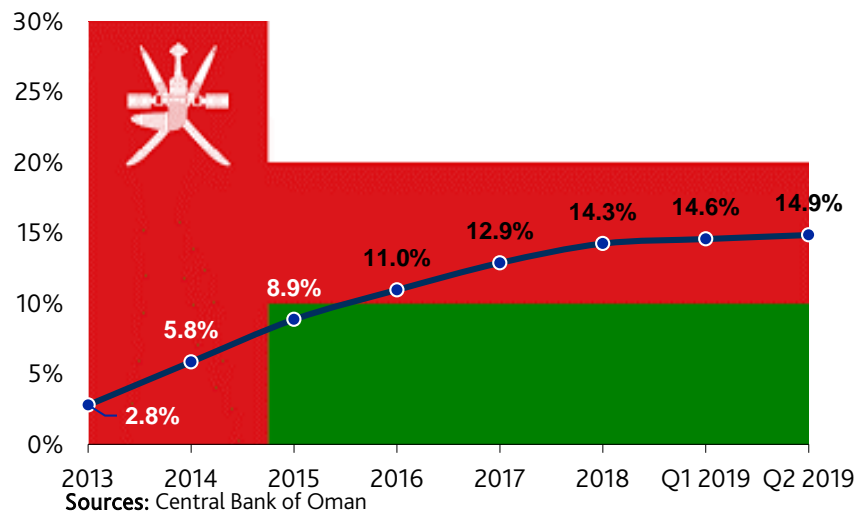
KEY ISLAMIC BANKING MARKETS: 2010-2018



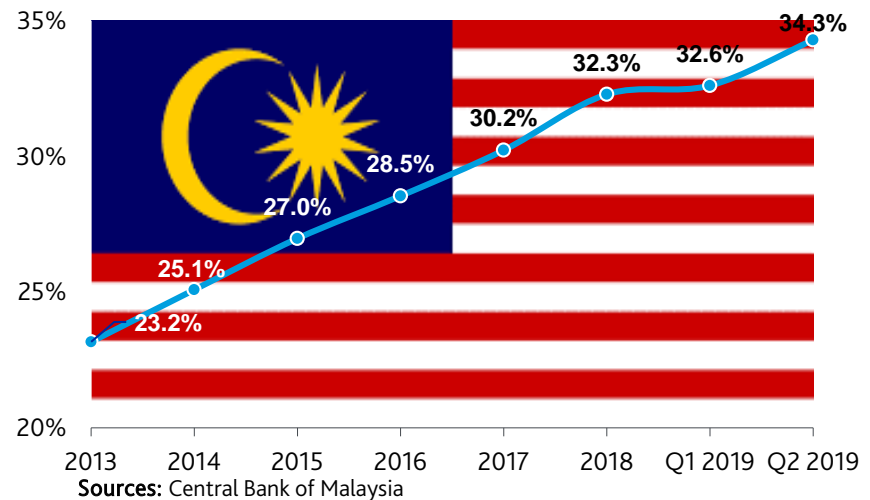
Sources: Central Bank data, Moody's Investors Service

Oman and Malaysia are the fastest growing Islamic financing markets

Oman is the fastest growing Islamic financing market
Islamic financing % of total financing



Malaysia is the biggest market in Southeast Asia
Islamic financing % of total financing



3

Islamic Finance in
frontier markets –
opportunities

a

Bangladesh

Robust economic growth and favorable demographics provide a foundation for further expansion of Islamic banking

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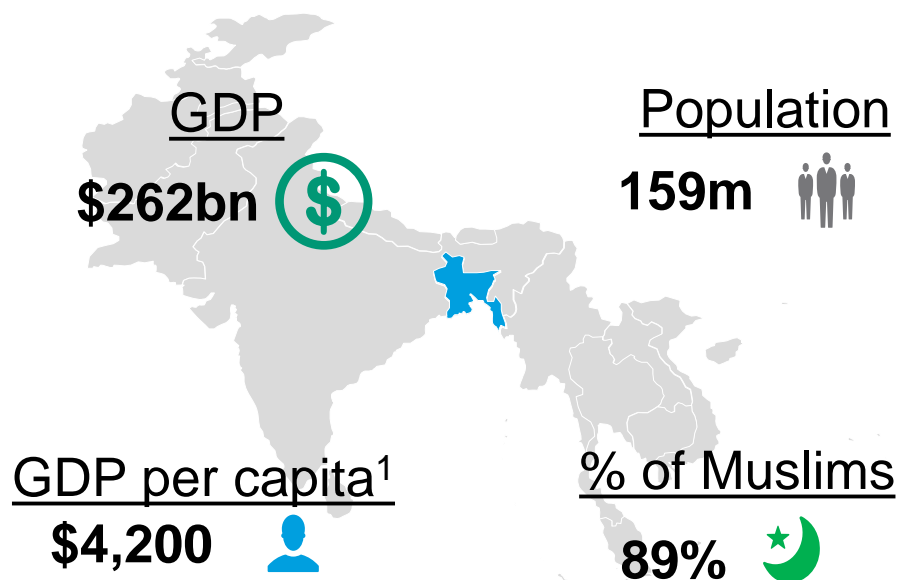
Ba3 Stable

Credit strengths

- » High growth prospects and track record of macroeconomic stability
- » Stable external payments position and ample fx reserve buffers
- » Modest general government and external debt burden

Credit challenges

- » Narrow tax base and very weak gvt revenues
- » Low per capita income relative to peers and limited economic diversification
- » Infrastructure and institutional constraints that weigh on competitiveness

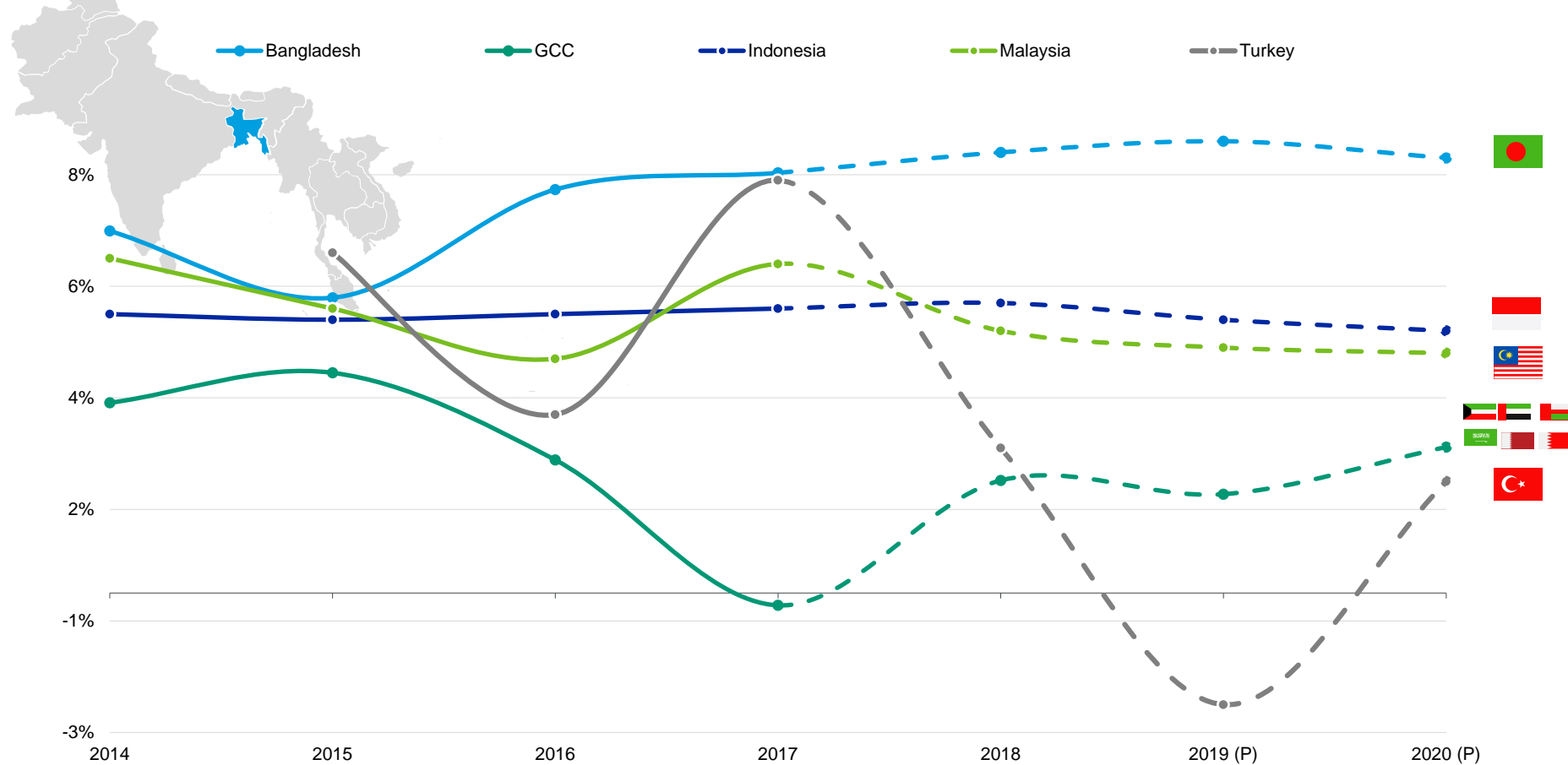


¹GDP per capita is at purchasing pricing parity

Source: Moody's, CIA Factbook

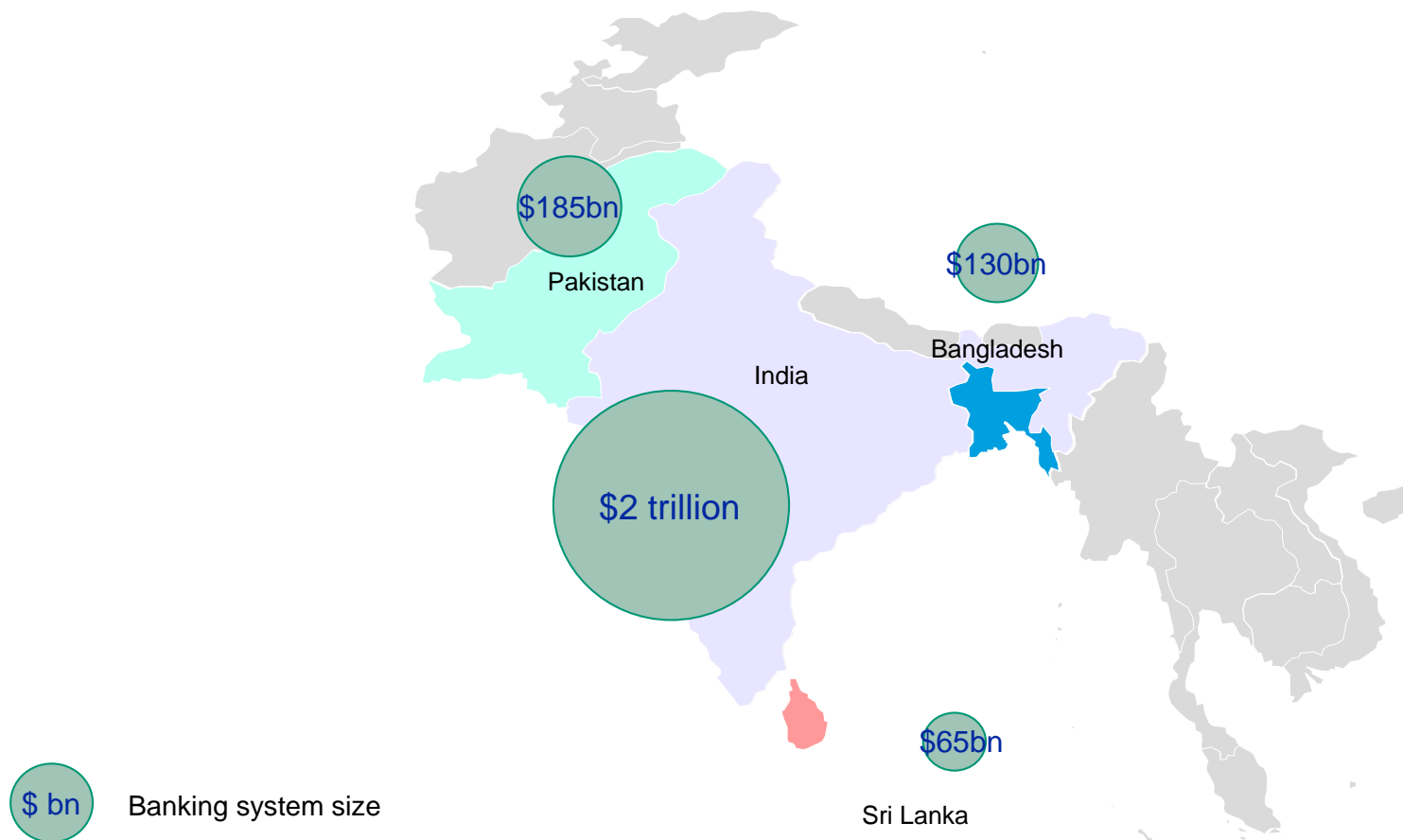
Strong economic growth in Bangladesh will create opportunities for Islamic banks

Real GDP Growth - (% year-on-year)



Source: Moody's, Bangladesh Central Bank

Bangladesh Banking system



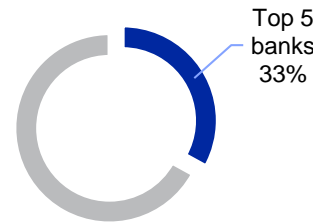
Source: Moody's, Central Banks, IMF

Bangladesh Banking system

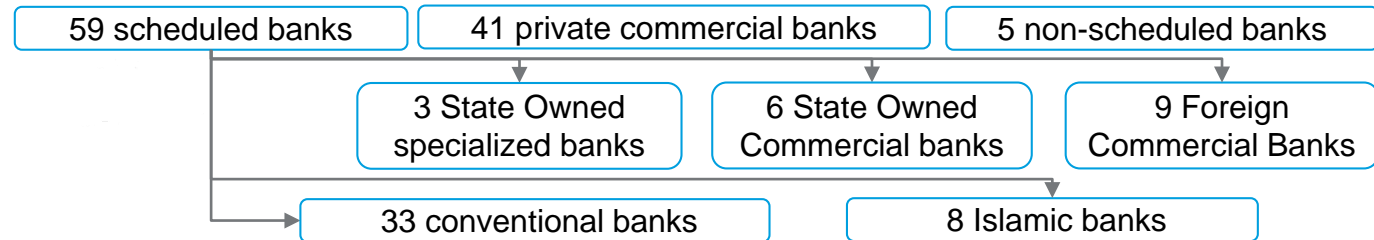
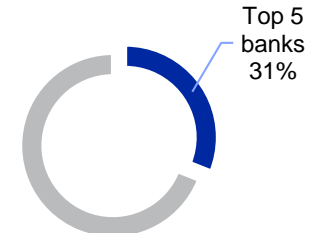


A fragmented banking system

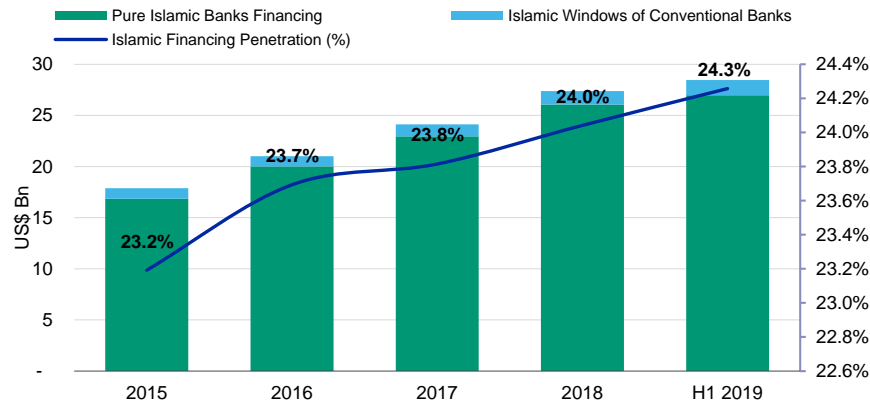
Top 5 banks share of deposits



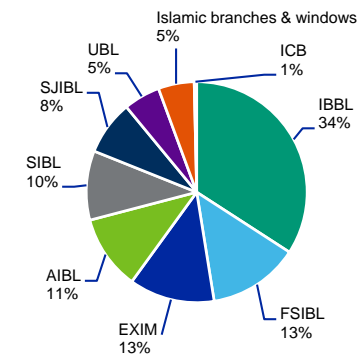
Top 5 banks share of assets



Islamic banks: Total Assets evolution 2015 - H1 2019



Islamic banks market share in 2018



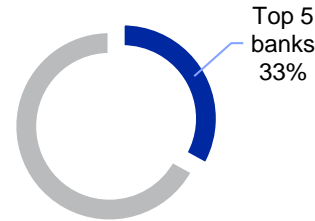
Source: Moody's, Central Banks, IMF

Bangladesh Banking system

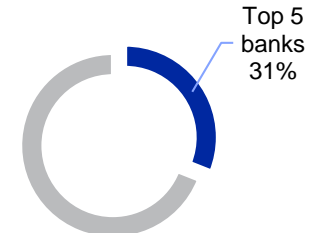


A fragmented banking system

Top 5 banks share of deposits



Top 5 banks share of assets



59 scheduled banks

41 private commercial banks

5 non-scheduled banks

3 State Owned
specialized banks

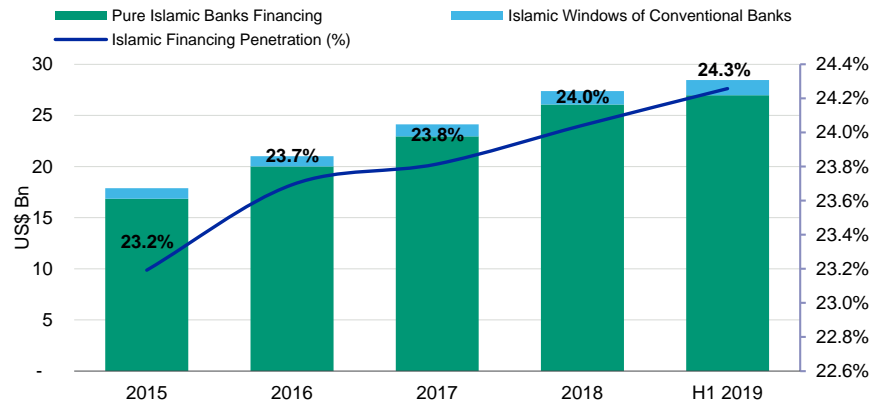
6 State Owned
Commercial banks

9 Foreign
Commercial Banks

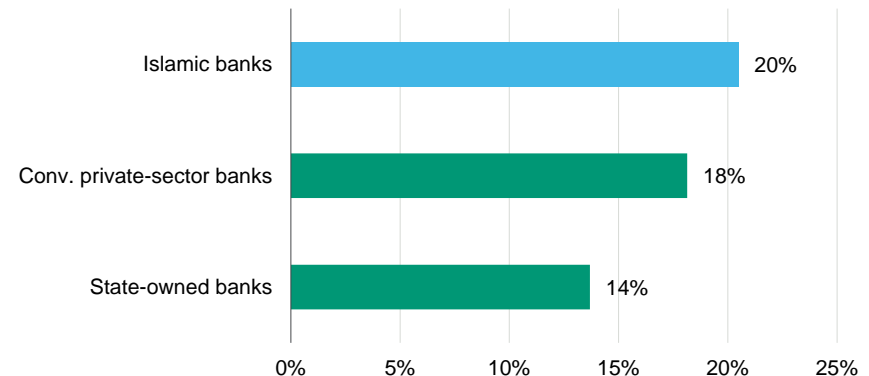
33 conventional banks

8 Islamic banks

Islamic banks: Total Assets evolution 2015 - H1 2019



Islamic vs conventional banks: CAGR 2008- 2018



Source: Moody's, Central Banks, IMF

Legal, regulatory & growing asset risk will limit growth potential



Need for a more comprehensive legal and regulatory framework on Shariah governance

- › Islamic banks operate under the same laws as conventional banks, with some basic Islamic provisions added.
- › Bangladesh has yet to establish a separate law that comprehensively covers Islamic banking.



Need for an authority to supervise Islamic banks' adherence to Shariah principles

- › Sharia compliance is largely the responsibility of banks
- › The central bank is not involved in approving Islamic products and does not inspect banks.
- › The Central Shariah Board for Islamic Banks of Bangladesh is an industry-led body



These developments are an obstacle to increasing public confidence in Islamic banks

- › Compliance with Shariah principles lacks transparency.
- › There could be conflicts of interest, given that members of a bank's supervisory committee are hired by its board.
- › This hinders them from acquiring new customers and growing business.

b

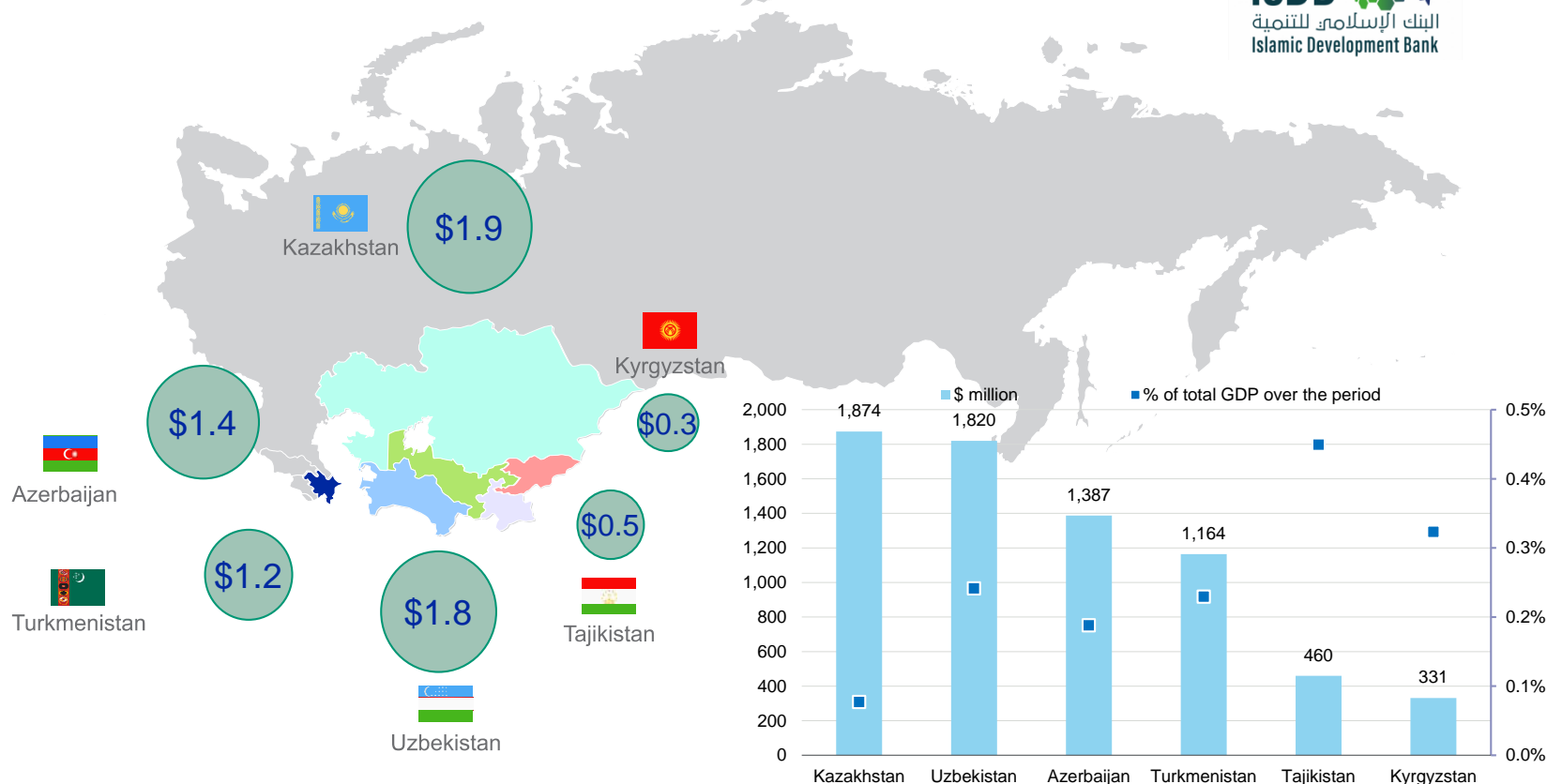
Commonwealth of
Independent States

CIS countries: main facts



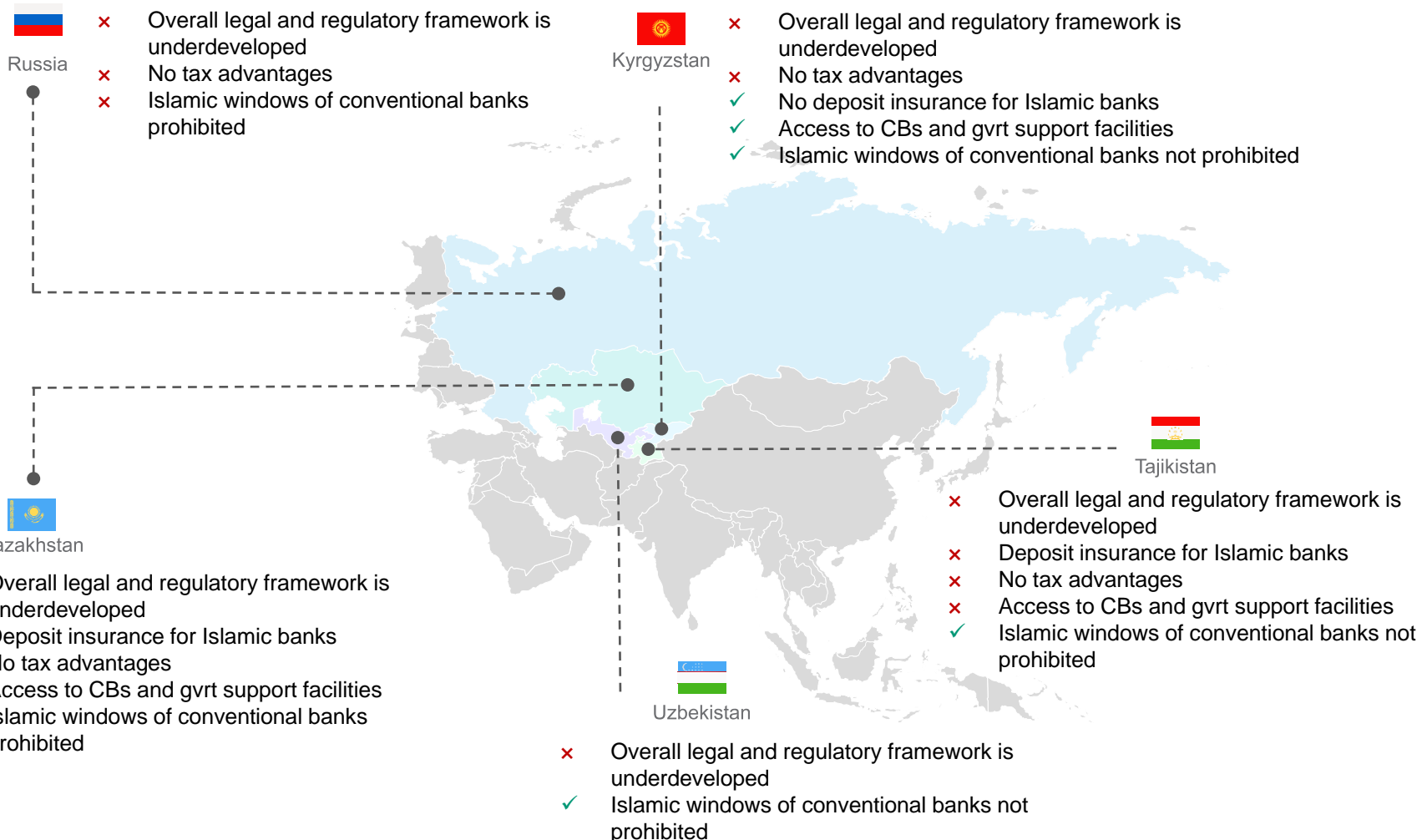
CIS: The Islamic Development Bank first set of funding will be a catalyst for the development of domestic Islamic finance

Amount of credit provided to CIS countries by IDB from 1991 to 2018



Kazakhstan and Kyrgyzstan will drive growth

Regulatory hurdles to Islamic banking: current state & proposed resolution in key CIS countries

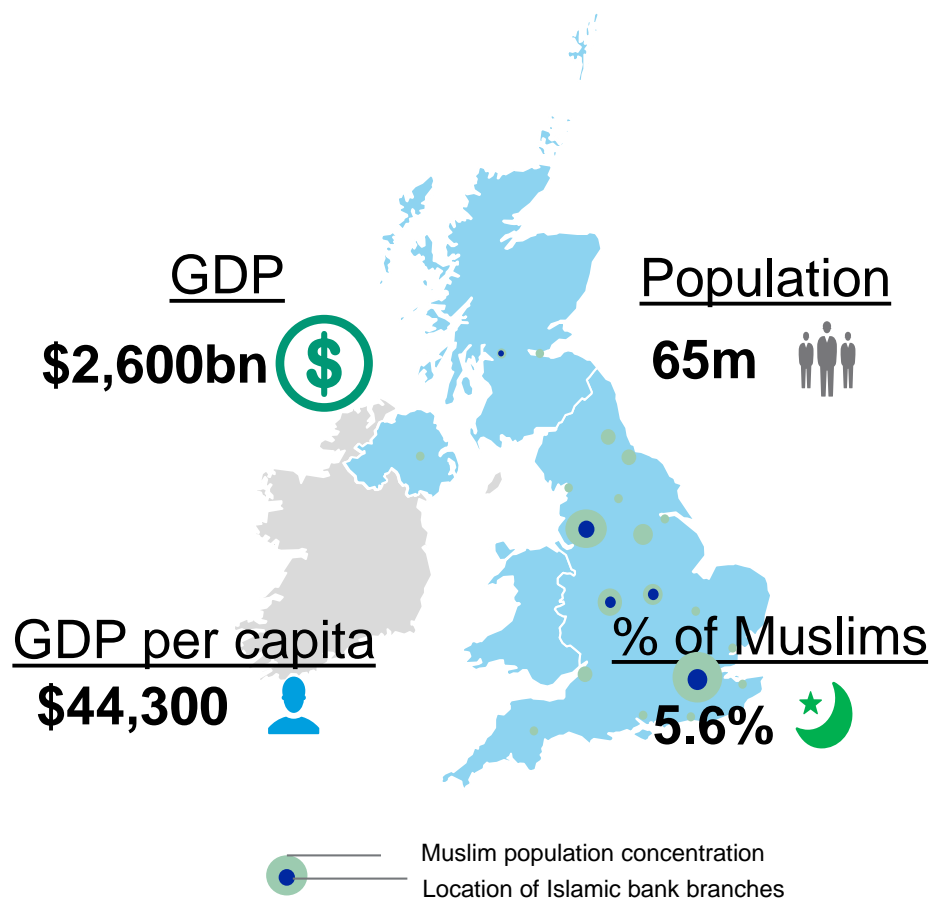


C



UK

UK: Main facts



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Aa2 Negative

Credit strengths

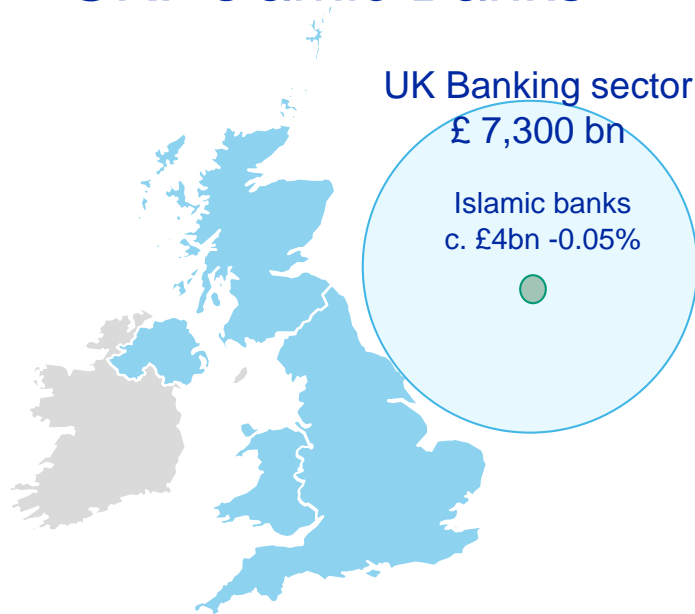
- » A large, flexible and competitive economy with high levels of wealth;
- » Limited government financing risks;
- » A sound monetary policy framework.

Credit challenges

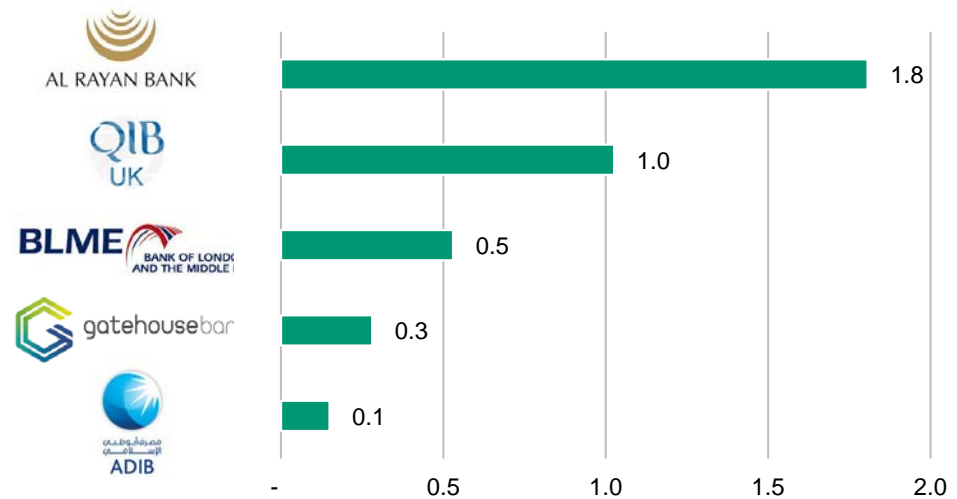
- » Weakening growth prospects;
- » Significant spending pressures that will likely leave the debt burden at a high level;
- » Weak productivity growth, high household debt and a large current-account deficit.

Sources: Company data, Bank of England

UK: Islamic Banks



Top 5 Islamic Banks by Total Assets (£ bn)



Conventional UK banks that have offered/ still offer IF services



3 UK branches of Islamic banks



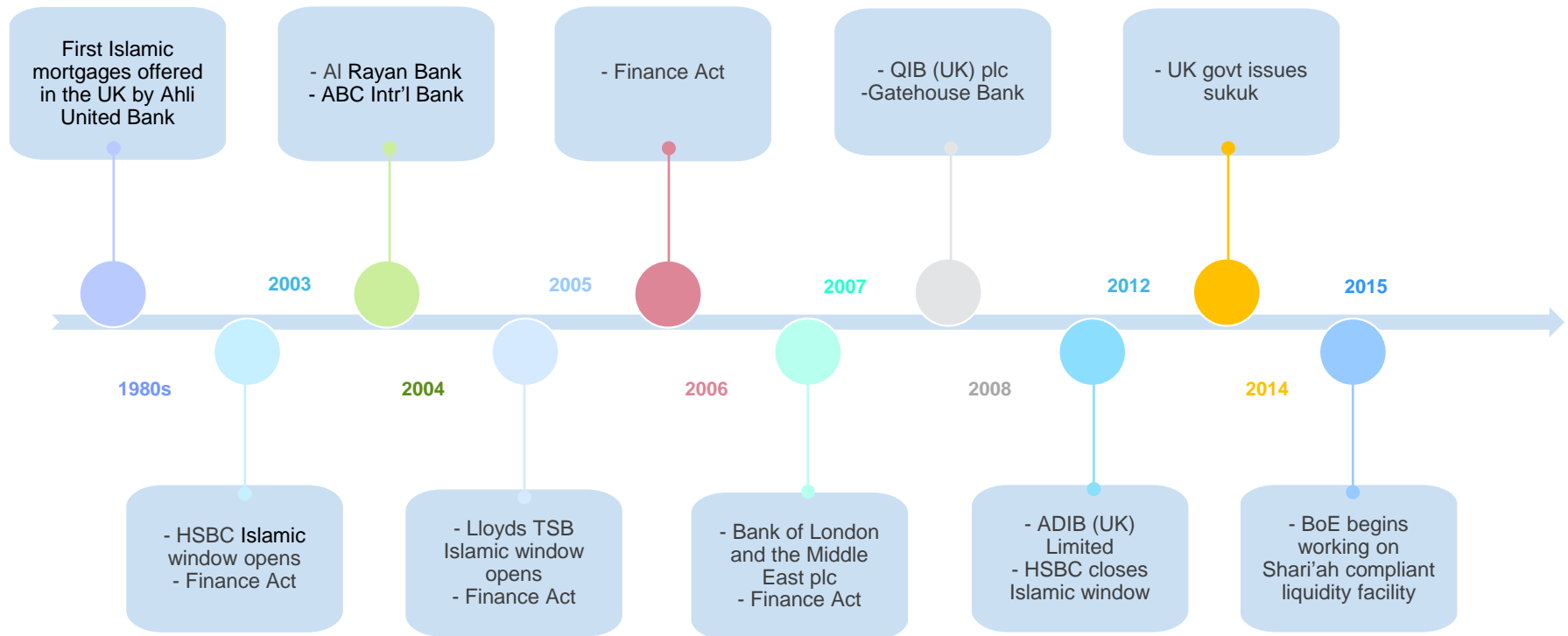
2 UK banks leaders in sukuk issuance



Sources: Company data, Bank of England

UK : Islamic banking is growing from low base

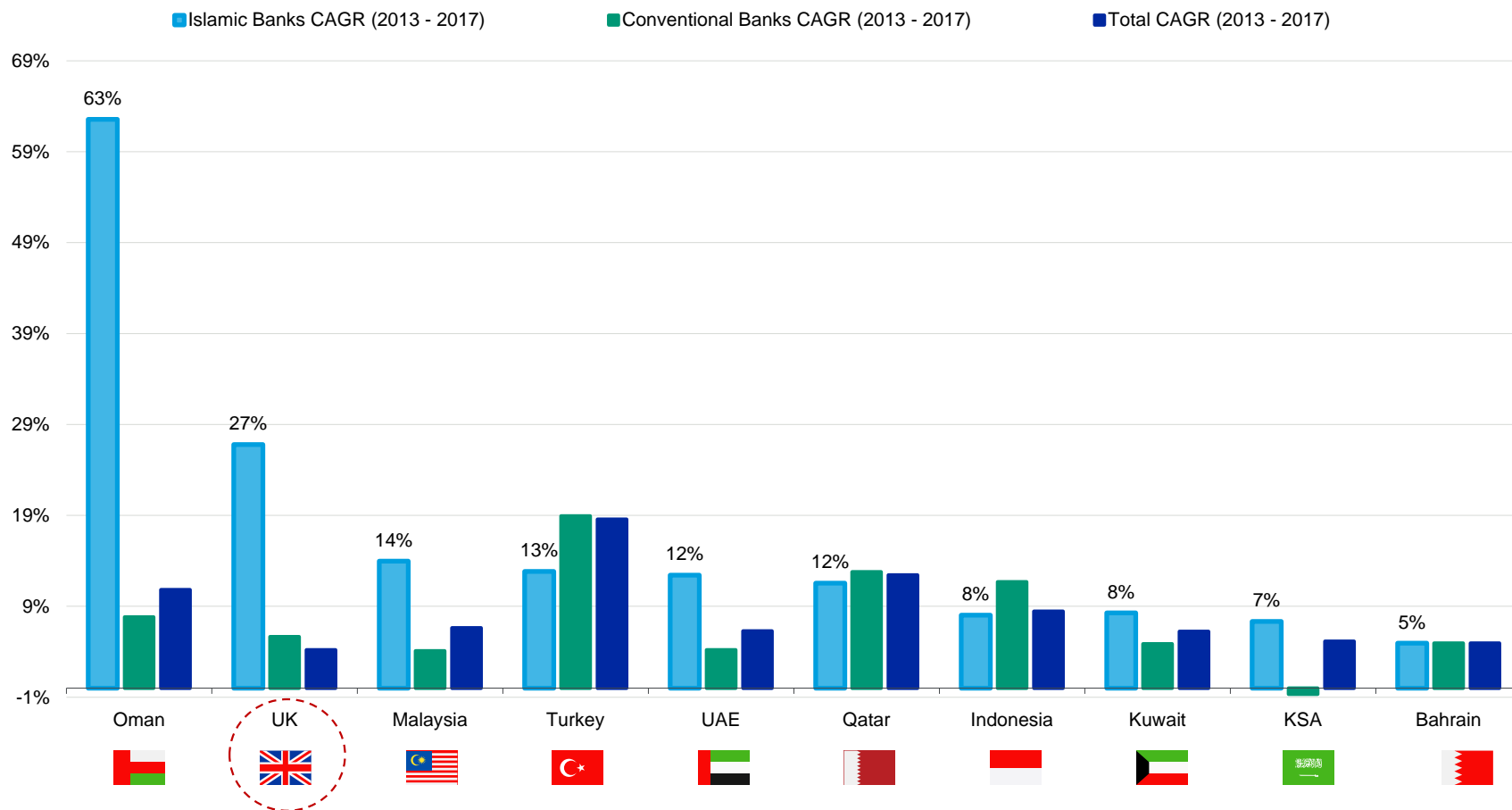
Timeline: Islamic mortgages on the UK market



Sources: Company data, Bank of England

UK : Islamic banking is growing from low base

UK Islamic banks grew strongly in 2013-2017



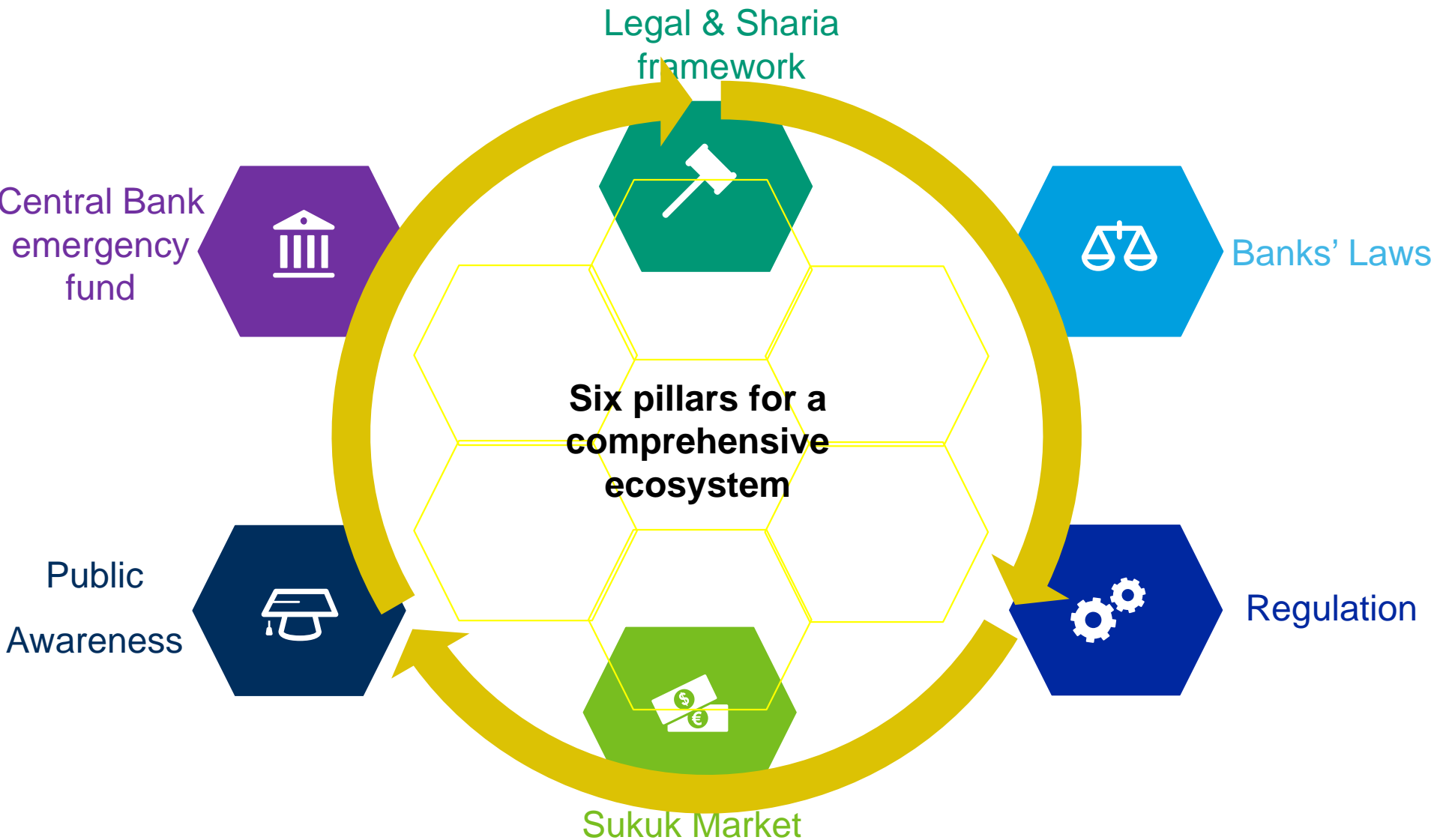
Sources: Moody's Investor Services

(*) This growth is for loan book

4

Key challenges for
the sustainable
development of
Islamic Finance

Islamic finance Ecosystem

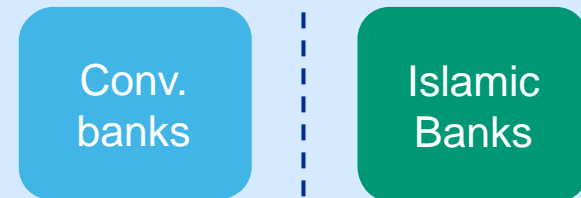


Islamic finance industry has three main business models

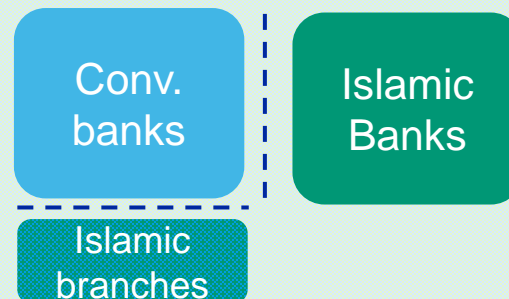
Segregated model



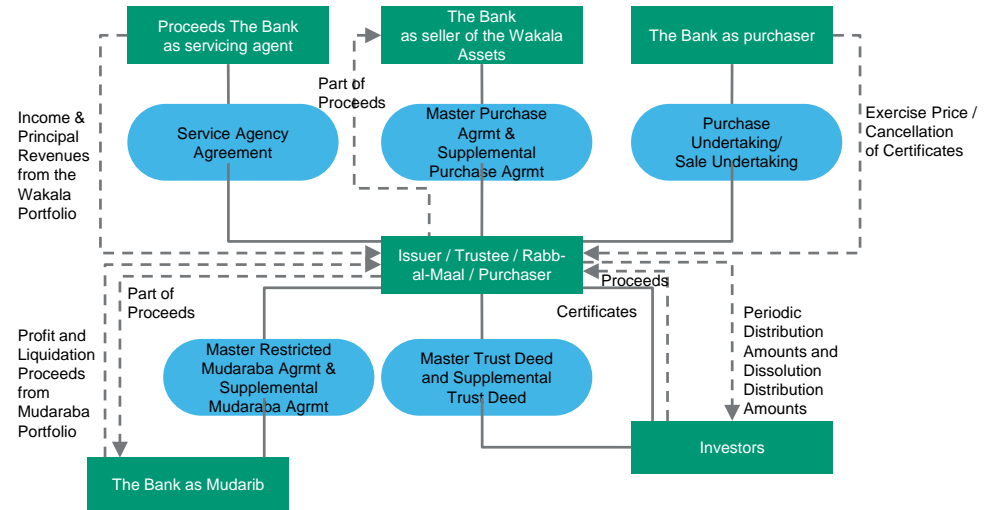
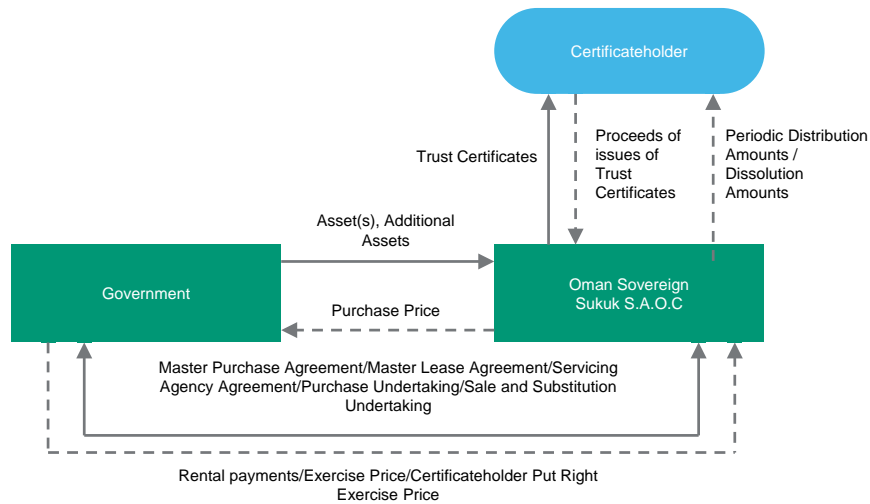
Hybrid model (a)



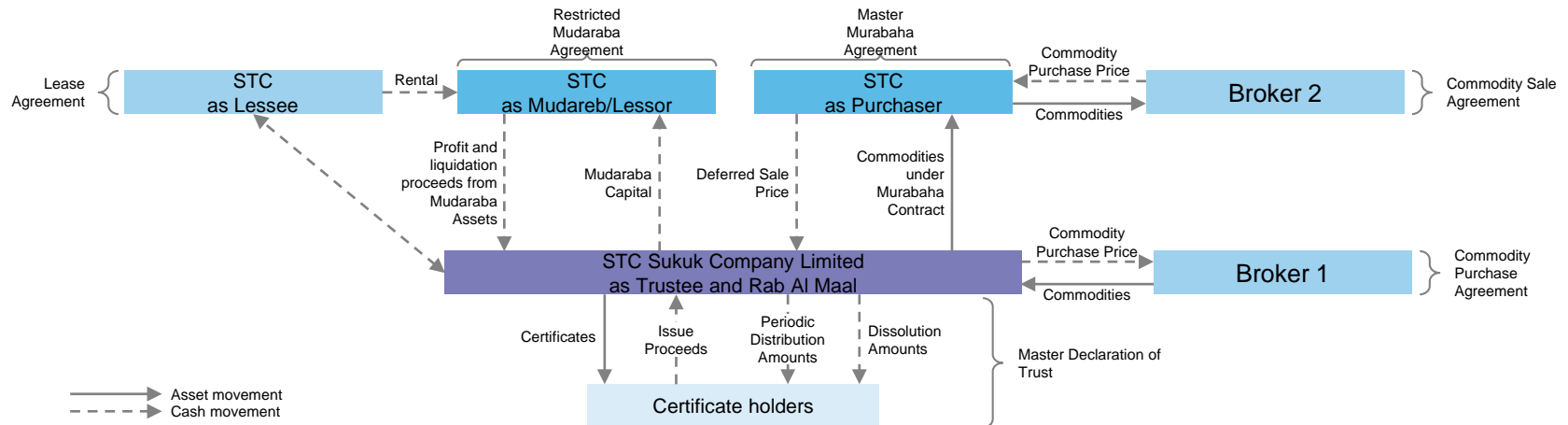
Hybrid model (b)



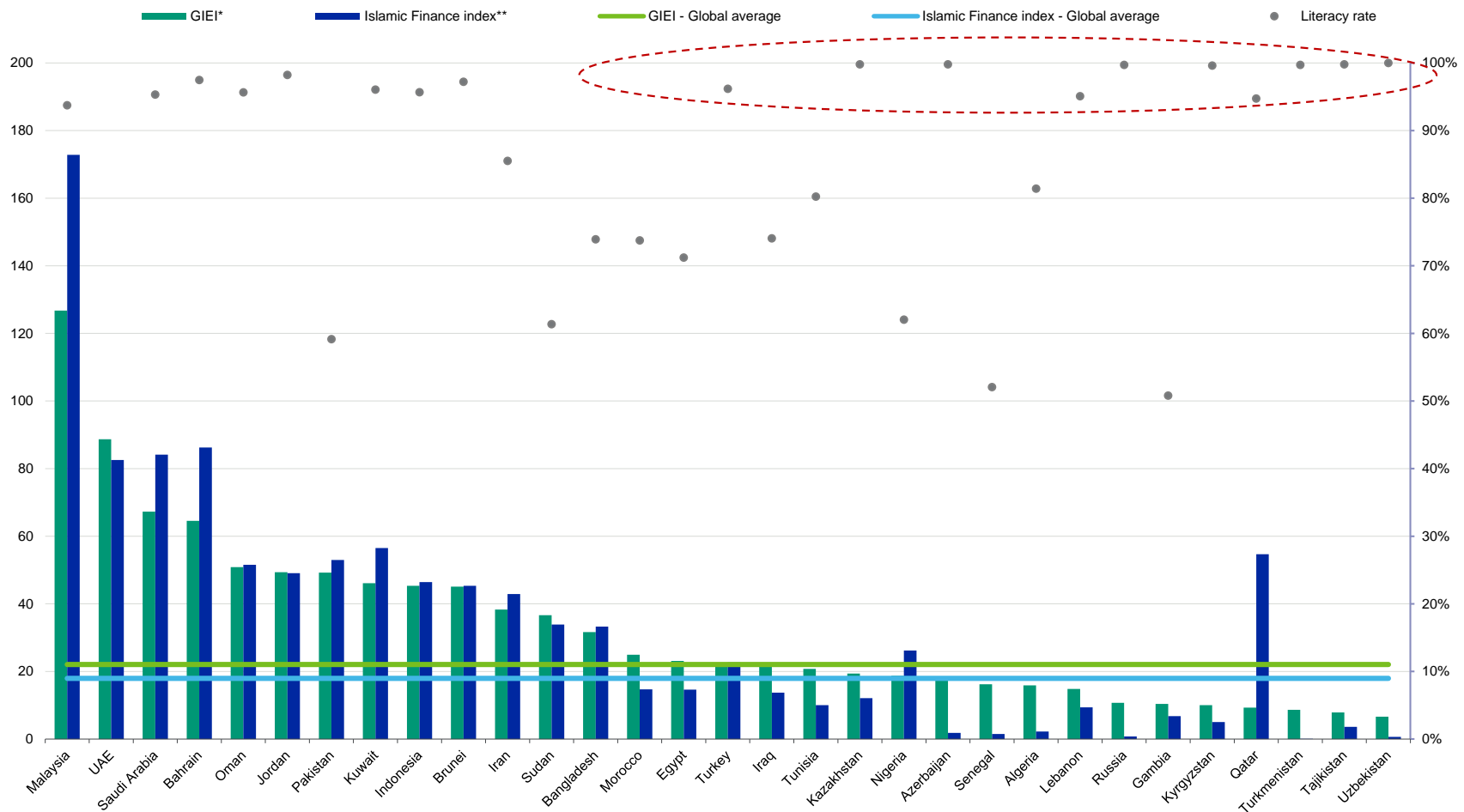
QIIB Trust Certificate Issuance Programme (January 2019)



Saudi Telecom Company Trust Certificate Issuance Programme (May 2019)



Public awareness



(*) **The Global Islamic Economy Indicator (GIEI)** is a composite weighted index composed by Thomson Reuters and DinarStandard which evaluates and ranks 73 countries based on the overall quality of their Islamic economic ecosystem. A total of 49 different categories are used to compile the indicator, including supply/demand drivers relative to country size, governance and awareness, and to social considerations.

(**) **The Islamic Finance Indicator** is one of the sub-indicators used to determine the GIEI indicator. It measures the quality of the Islamic finance industry through four dimensions: financial, governance, awareness & social

Sources: World Bank, Thomson Reuters

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Thank you



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